RETAIL DEALERS AGREEMENT ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON BUSINESS, TRADE, AND TOURISM

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

S. 1256

TO REGULATE COMMERCE BY PROTECTING THE RIGHTS OF CONSUMERS, DEALERS, AND END-USERS

OCTOBER 29, 1981

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RETAIL DEALERS AGREEMENT ACT

THURSDAY, OCTOBER 29, 1981

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON BUSINESS, TRADE, AND TOURISM,
Washington, D.C.

The subcommittee met at 9:41 a.m., in room 235 of the Russell Senate Office Building; Hon. Larry Pressler (chairman of the subcommittee) presiding.

OPENING STATEMENT BY SENATOR PRESSLER

Senator PRESSLER. I would like to welcome you all to this hearing of the Business, Trade, and Tourism Subcommittee. We will be receiving testimony regarding the Retail Dealers' Agreement Act, S. 1256.

Coming from a State where small business is the backbone of the economy, I am very aware of the difficulties facing the thousands of people in this country who are engaged in small business operations. For instance, I strongly believe, and my constituents keep telling me, that high interest rates are the single most serious issue confronting small businessmen today.

I have asked the President to look closely at this problem, and I have introduced legislation which would require the Federal Reserve Board to include small business and farm representation in its membership.

As a former member of the Senate Small Business Committee and the House Small Business Committee when I was a Congressman, I am particularly interested in knowing of ways that Congress can help America's small businessmen without imposing burdensome government regulation or unnecessary government interference.

Once again in today's hearing, I'm pleased that we are discussing a piece of legislation which primarily affects small businesses. This has been the case with most of the activities of the subcommittee this year. In February I chaired field hearings on the problem of barriers to small business exports. The subcommittee has taken the lead on issues involving the travel and tourism industry, which is 99 percent small business. And just last week we held hearings on the Service Industries Development Act, a measure which will promote expanded service industry growth and export opportunities. Again, many of the individual businesses which comprise the service sector are in the small to medium-size range.

One of the common themes I have found during all these hearings is that the U.S. Government tends to lack the aggressiveness

necessary for us to get a fair shake from our trading partners. Time and again we find that we are making all the concessions toward achieving the goal of fair and open international trade. This imbalance has often resulted in American businesses being shortchanged by foreign suppliers and competitors both here and abroad.

In today's testimony, for instance, we will hear that many foreign manufacturers of office equipment are not acting in good faith in their dealings with their American representatives who make up the dealer network. These small businessmen cannot confront the huge international manufacturing concerns on an equal basis. They need assistance if they are to be treated fairly, and I am looking forward to hearing what relief S. 1256 offers in this regard.

We have two fine witnesses from South Dakota, one from Watertown and one from Aberdeen, whom I will be introducing later.

I shall now ask Senator Exon for his opening statement, and I want to praise him for raising this subject and this issue and developing this legislation which will be very helpful.

Senator Exon?

OPENING STATEMENT BY SENATOR EXON

Senator Exon. Thank you, Mr. Chairman.

I want to welcome those who are here this morning—I look forward to their testimony and their input on this bill.

I would like to thank you, Mr. Chairman, for convening this hearing today, and I appreciate the interest that you have shown in this issue.

I introduced S. 1256, the Retail Dealers' Agreement Act, to strengthen the position of the small office machine dealer in negotiations with large and powerful suppliers. This industry is comprised mainly of 30,000 small businessmen throughout the country who market and service office machines and other office equipment. These dealers are critical in today's sophisticated business world.

What concerns me, Mr. Chairman, and the reason for this hearing today is the plight of the small businessman.

Over the last few years, Japanese and European manufacturers have captured large shares of the small office equipment market. For example, in 1979 imports of business machines imported from Japan totaled more than $1 billion. This strong position was accomplished by a combination of product innovation, competitive pricing, and aggressive marketing by the U.S. dealers.

Dependence on foreign suppliers leads to manufacturers' strong bargaining power. Unfortunately, this trend has caused small dealers here in the United States to suffer serious financial losses in many cases. Some estimates of loss run as high as $30 million annually. The problems include no dealer input into selling quotas and quota levels, no compensation for correcting design defects in new machines, false claims by the manufacturers and arbitrary cancellation of contracts.

I feel that we must do something to prevent these abuses in the future and strengthen the small office machine dealers. I believe that the Retail Dealers' Agreement Act will accomplish these goals.

The bill gives the dealer a legal cause of action when a supplier does not act in good faith. "Good faith" is defined as freedom from coercion, intimidation, threat, fraud, or unconscionable conduct. This begins at the inception of the agreement and runs through its termination.

The bill also affords existing dealers a legal cause of action when a supplier enters into a distribution agreement with another dealer in the same market area without giving 60 days notice to the existing dealers. If the existing dealer objects to the new agreement, the bill provides guidelines for the court to use prior to the establishment of the second dealership.

This bill is patterned after the Automobile Dealers' Day in Court Act, which has been in effect since 1956. I believe that S. 1256 will provide the small businessman an opportunity to fairly and equitably contract with suppliers. It is my hope that this will lead to a healthier financial climate in the office equipment business.

I have been made aware, Mr. Chairman, of some concern with regard to the intended coverage of this legislation. Let me say again, this bill is intended to cover office machine dealers who have experienced great difficulties due to abusive marketing practices conducted by basically a few foreign manufacturers. This bill is not intended, nor do I believe it covers or goes beyond these boundaries.

However, I am always sensitive to constructive criticism and want all parties to know that I will cooperate with any who may continue to have concerns in this area once these hearings are concluded.

In closing, Mr. Chairman, let me thank the chairman and all of the staff who have been involved in this matter. I look forward to the comments expressed during this hearing today by all of the witnesses, most especially, I might say, Mr. Chairman, from John Kuchta, whom I have known very well and very favorably for a long, long time, since he is from the place where I live in Lincoln, Nebr.

I thank the Chairman.

Senator PRESSLER. Thank you, Senator Exon.

We shall now hear the opening statement from Senator Ford.

OPENING STATEMENT BY SENATOR FORD

Senator FORD. I am delighted to see my good friend Bruce Cotton here to be one of the witnesses today. I regret I will not be able to stay and listen to all of the witnesses this morning.

Here today, I agree with my distinguished colleague and friend from Nebraska that he is on the right track as it relates to this particular area.

I see in a major piece of legislation we just passed, the telecommunications bill—in the long run it will force some of the smaller companies—and they are large compared to some, but very small compared to A.T. & T.—into a competitive position which will ultimately mean Japanese technology in this country.

I think we have a broader question here today than just one industry, one business. If we are going to continue to see Main Street, U.S.A., dwindle under the present economic circumstances, then we have to do a lot of rethinking.

I applaud the chairman and my colleague from Nebraska for what they are attempting to do today, and I look forward to assisting them in any way possible to see that this legislation comes into being.

I am delighted to hear the sponsor of the legislation say that this does not apply to any other business.

Thank you, Mr. Chairman.

Senator PRESSLER. Thank you for those remarks.

I certainly join in welcoming two South Dakotans, one who will be testifying for it and one against. I welcome that situation. We do have lively debates around here, but also we need to shed some light on the relationship of franchises, the relationship of small businessmen to big business. Increasingly, I hear complaints from small businessmen who have built a business and built a reputation through advertising and so forth, worked at it for a number of years, and they feel they have very few rights. The question of how to protect those rights is one of the things we are going to be discussing.

[The bill follows:]

II

97TH CONGRESS
1ST SESSION

S. 1256

To regulate interstate commerce by protecting the rights of consumers, dealers, and end-users.

IN THE SENATE OF THE UNITED STATES

MAY 21 (legislative day, APRIL 27), 1981

Mr. EXON (for himself, Mr. FORD, Mr. CANNON, Mr. HEFLIN, and Mr. PRESSLER) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

SEPTEMBER 9, 1981

Ordered referred jointly to the Committee on the Judiciary and the Committee on Commerce, Science, and Transportation

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A BILL

To regulate interstate commerce by protecting the rights of consumers, dealers, and end-users.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act shall be cited as the "Retail Dealers' Agreement Act".

DEFINITIONS

SEC. 2. As used in this Act the term—

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(1) "dealer" means any person, corporation, partnership, association of dealers, or other form of business enterprise resident in the United States or in any territory thereof operating under the terms of a dealer agreement and engaged in the business of selling the product of a supplier to consumers or other end-users in any office of business environment;

(2) "supplier" means a manufacturer, distributor, or wholesaler who enters into a dealer agreement with a dealer in order to supply the dealer with a product;

(3) "manufacturer" means any person, corporation, partnership, or other form of business enterprise engaged in the sale, consignment, exchange, or any other form of transfer of a product which it manufactures, assembles, constructs, or creates;

(4) "distributor" means any person, corporation, partnership, or other form of business enterprise engaged in the sale, consignment, exchange, or any other form of transfer of a product which it manufactures, assembles, constructs, creates, or obtains in any manner from a manufacturer; and

(5) "wholesaler" means any person, corporation, partnership, or other form of business enterprise engaged in the sale, consignment, exchange, or any other

form of transfer (primarily to dealers) of a product which it obtains from a manufacturer or distributor;

(6) "product" means any physical object, software, method, or service used in an office or business environment;

(7) "service" means installation and after-sales support;

(8) "dealer agreement" means any agreement or contract, written or oral, for a definite or indefinite period between any supplier engaged in commerce and any dealer which purports to fix the legal rights and liabilities of the parties to such agreement or contract;

(9) "United States" means the several States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, and the Trust Territory of the Pacific Islands;

(10) "commerce" means commerce within the United States or between the United States and foreign nations, or in any territory of the United States, or in the District of Columbia, or among the territories or between any territory and any State or foreign nation or between the District of Columbia or any State or territory or foreign nation;

(11) "good faith" means the duty of each party to any dealer agreement, and all officers, employees, agents, or other representatives thereof, to act in a fair, equitable manner toward each other so as to guarantee each party freedom from coercion, intimidation, threats of coercion or intimidation, fraud, or unconscionable conduct by the other party; and

(12) "market area" means the dealer's geographic selling area of responsibility as defined in a dealer agreement, or, if not defined in the dealer agreement, the geographic area, within one hundred miles of the dealer's primary place of business in which the dealer principally conducts its business, including selling the product, servicing the product, and in other ways satisfying the needs of the end-users of the product.

VIOLATIONS

SEC. 3. (a) It shall be a violation of this Act for any supplier—

(1) to induce a dealer to enter into a dealer agreement by fraud;

(2) to fail to act in good faith in performing or complying with any terms or provisions of a dealer agreement, including furnishing the dealer with products, parts, reference manuals, and schematics on a timely basis;

(3) to fail to act in good faith in terminating, canceling, or refusing to renew any dealer agreement; or

(4) to enter into a dealer agreement with a dealer whereby the dealer will conduct business in a market area which is already the market area of another dealer or dealers of the same product without providing sixty days notice of the proposed dealer agreement to the existing dealer or dealers of the same product in the relevant market area.

(b)(1) In the event the presently existing dealer or dealers object in a timely manner to the establishment of the proposed dealership, the propriety of the establishment of the proposed dealership shall be determined with reference to the guidelines set forth in paragraph (2). Nothing herein shall be construed to prevent a supplier from implementing affirmative action programs providing business opportunities for minorities or from complying with applicable Federal, State, and local law.

(2) In any proceeding in which a violation of paragraph (1) is claimed, the court shall consider all pertinent circumstances surrounding the establishment of a new dealership in the relevant market area, including—

(A) whether the establishment of such additional dealership is warranted by current economic and marketing conditions;

(B) the current and past volume of retail sales and service business for the product transacted in the relevant market;

(C) the effect the investment made and obligations incurred by the objecting dealer or dealers in the relevant market area would be diminished by the establishment of another dealership;

(D) the permanency of the investment of the objecting dealer or dealers in the relevant market area;

(E) whether the objecting dealer or dealers in the relevant market area are providing adequate competition, convenient end-user service, adequate sales, and service facilities, equipment, parts, and qualified personnel to reasonably provide for the needs of the end-user of the products sold and serviced in the relevant market area: *Provided, however,* That the desire for further market penetration, of itself, shall not serve as the justification for allowing the establishment of a new dealership in the relevant market area;

(F) the manufacturer's previous representations regarding future dealer establishment; and

(G) the ability of the objecting dealer or dealers to meet existing and future supplier quotas in light of the establishment of another dealer.

(3) In any action brought under this Act the dealer's lack of good faith may be raised as a defense.

(4) A supplier may terminate, cancel, or refuse to renew a dealer agreement by offering the dealer fair and reasonable compensation for the value of the dealer agreement to the dealership, including a reasonable amount for goodwill. Nothing in this section shall be construed to affect the right of a supplier to terminate a dealer agreement for just, good, and significant cause.

DEALER'S RIGHTS TO REPRESENTATION

SEC. 4. No supplier shall deny to any dealer or prospective dealer the right to be accompanied by counsel or a personal representative to any meeting between the parties for the purpose of discussing any matter regarding a dealership or a proposed dealer agreement.

FREE ASSOCIATION

SEC. 5. Every dealer shall have the right of free association with other dealers for any lawful purpose, and no supplier shall interfere in any way with any dealer's exercise of such right. Any dealer or groups of dealers whose right has been so violated may bring an action to enjoin such supplier from such action.

CIVIL ACTION

SEC. 6. Any dealer affected by a supplier's violation of this Act may bring an action against such supplier in any

district court of the United States in the district in which the supplier resides, is found, has an agent, or does business, without respect to the amount in controversy, for damages, injunctive or other equitable relief, attorney's fees, and the costs of suit. If the court finds the violation was willful, the court may increase the amount recovered as damages to a total of three times the amount of actual damages.

LIMITATIONS

SEC. 7. Actions arising out of any provision of this Act shall be commenced not later than four years after the violation occurs. If a supplier liable hereunder conceals the cause of action from the knowledge of the person or entity entitled to bring it, the period prior to the discovery of the cause of action by the person or entity entitled shall be excluded in determining the time limited for the commencement of the action.

ANTITRUST LAWS

SEC. 8. Nothing in this Act shall be construed to repeal, modify, or supersede, directly or indirectly, any provision of the antitrust laws of the United States, as defined in section 1 of the Clayton Act (15 U.S.C. 12), and section 4 of the Federal Trade Commission Act (15 U.S.C. 44), and any State antitrust law.

EFFECT ON STATE LAW

SEC. 9. Nothing in this Act shall supersede the right of any State to enact or enforce any law which provides additional or stronger standards, criteria, or remedies than those provided in this Act.

EFFECT OF CONTRACT

SEC. 10. Any condition, stipulation, or provision purporting to bind any dealer or any person acquiring any dealership to waive compliance with any provision of this Act is void.

Senator PRESSLER. Unless my two colleagues have more things to add, I shall call the first panel forward.

Our first statement is going to be Tom Van Gelder, president, Van's Office Machines, Inc.

Mr. Van Gelder?

STATEMENT OF TOM VAN GELDER, IMMEDIATE PAST PRESIDENT, NATIONAL OFFICE MACHINE DEALERS ASSOCIATION

Mr. VAN GELDER. Good morning, Mr. Chairman, Senator Exon, Senator Ford.

My name is Tom Van Gelder. I am the immediate past president of the National Office Machine Dealers and also chairman of their political action committee. We are a nonprofit organization of approximately 5,000 members. We are independent businessmen in our local communities. We join together through an association for a common effort to educate our members in management, marketing, technical skills, and procedures so that they can individually run their businesses better.

The association of the National Office Machine Dealers represents the vast majority of the dealers in this industry. Geographically these dealers operate in all 50 States of the United States and 10 foreign countries. They sell a vast number of copiers, typewriters, electronic cash registers, dictating equipment, word processing, offset and duplicating, data processing equipment, microfilm, microfiche, and many other lines that are used in the business community.

As an association, we have a unique volunteer thrust. All of its officers and committee chairman work together on a volunteer basis. We actually prepare the programs of our association for the dealer. We present these programs by the dealer for our members. We have annual regional and national conventions and trade

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shows. This year we met in July in Las Vegas. We had approximately 20,000 from our industry move through our trade exhibits.

We were indeed fortunate to have President Ford speak to us on our political action committee. We were also very pleased to have President Reagan speak to us 2 years ago as a celebrity speaker.

Our profiled dealer member is an independent businessman in the local community, has approximately 20 employees, does somewhere between a half to $1 million worth of gross volume each year. He is deeply rooted in his community, participates in civic and fraternal activities. We feel that he is part of the fabric of that community.

Unfortunately, I do have to report to this committee that due to the topics we are going to discuss today, many of them went into bankruptcy, have lost their businesses. In some cases, they have lost their homes, which we think is a sad state of affairs.

Most of this is because of lack of fair and equitable treatment on the part of our suppliers. I would like to go through a scenario of how this came about.

The independent dealer, in developing the right mix of manufacturers that he wishes to represent, he can choose from among many. But increasingly they are of foreign origin, particularly Japanese. There are very few U.S. manufacturers that our dealers can work with, most of the major companies today in the United States such as the IBM's, the Xeroxes, NCR's, have their own marketing groups.

The alternate is to market through our viable network of dealers. We need to select a product to market. In the selection process, we find that it is increasingly more foreign manufacturers such as from Europe—Adler, Royal, Hermes, Olivetti, Olympia. However, the Japanese firms now provide the majority of the dealer product lines. These are giant companies such as Cannon, Minolta, Sharpe, Sony, Toshiba, and others.

The problem which my colleagues will discuss today did not even exist 10 years ago. In 1970 when Senator Exon sold his business, he did not carry a Japanese product in his store, only because they had not yet entered this marketplace. However, that same business today, 50 percent of the products that are sold are Japanese products.

The entry of the Japanese, virtually eliminating American companies, is a factor in the dealer source of products for his business, not unlike our country's dependence on foreign oil. Dealers today must look beyond our borders for a viable product to market in this country.

In 1979, the imports of business machines and parts from Japan alone totaled more than $1 billion. This means more than 70 percent of the products sold came from abroad. Realizing this vacuum, the Japanese and European firms began developing attractive low-cost machines for small volume use. And realizing that in order to maintain a competitive edge, the manufacturer began to introduce new products as rapidly as possible, leaving final product testing to be done in the end user's establishment.

Unfortunately, we find it is becoming a consumer problem. We, as the dealer selling foreign products, to the end user is where the

actual field testing is being done. There is lack of quality control. The dealer is losing his credibility in the marketplace.

The foreign manufacturer seeking a distribution network for his products looked for an existing marketing arm, which is our NOMDA dealer network of independent office machine dealers.

I think it should be mentioned, for the manufacturer to put together a marketing arm today, a viable marketing arm, would be a tremendous expense.

There is a lot of risk involved for the dealer to establish a aggressive marketing and reliable service network for the manufacturer. The independent dealer invests a great deal of time and money, and the foreign manufacturers success and market share would not approach the level they currently enjoy had it not been for our dealer members.

Unfortunately, the resulting dependence of the dealer on the foreign products, without any alternative sources of supply, has allowed these manufacturers to acquire an inordinate bargaining power. The small dealer has committed, a substantial investment of time and money to his office machine dealership. He has developed brand name recognition and market share for the manufacturer.

However, with limited bargaining power against the big firms, he has no way of protecting this asset, which a supplier can destroy at the drop of a hat through termination or nonrenewal.

What is worse, even success is not adequate to make this asset grow and prosper, as the supplier will often seek to use that success to further solidify his position in the marketplace, at the dealers expense.

Getting down to the nitty-gritty, Mr. Chairman, given the context of unequal bargaining power between the dealer and the supplier, the problems I have alluded to above can be generally categorized as follows: Lack of good faith by the manufacturer vis-a-vis the dealer, arbitrary establishment of usually unrealistic sales quotas, and the use of coercion in this matter.

There is a lack of incentive for manufacturers to negotiate in good faith on serious problems of product reliability.

They saturated the market with new dealers when it was not warranted. Arbitrary terminations or nonrenewals, unfair competition by the establishment of wholly owned retail outlets in existing dealers' market areas.

I think other witnesses will discuss these problem areas in greater detail. However, let me explain what we as dealers have done to try to put an end to these unfair manufacturing practices. In this way, you can better understand why a legislative remedy is the best, if not the only, solution to our problem.

We are very proud of our model dealer agreement, which we developed ourselves as an association. We went to the manufacturers to discuss it with them. This dealer agreement we felt was fair and equitable to both the manufacturer and the dealer, as long as they were going to treat each other fair and equitably and with ethics. The agreement was going to be an open ended agreement. The agreement also said that we would participate in the setting of mutually agreed upon sales quotas, and that any problems that we

might have, or would develop, would be taken care of through arbitration proceedings.

Unfortunately, the vast majority of our manufacturers will not state in their agreements that they will treat a dealer in a fair and equitable manner, nor do they have any intention of even discussing the remaining points of the proposed agreement we have submitted. We have been told very bluntly and unequivocally by one supplier they have no intention of treating us fairly, that they like it the way it is.

Now, to overcome this reluctance, NOMDA for the last 3 years has sent delegations to Japan. I have participated in those negotiations firsthand for the past 3 years. Despite repeated assurances and promises to look into the problems we have specifically documented, very little action has been taken by the manufacturers.

After 3 years of all talk and no action, it seems that their response is very clear: They do not want to negotiate. Dealers have sought relief in the courts and unfortunately, the dealers have found their interests are not sufficiently protected by such agreements, and furthermore that the courts are reluctant to go beyond them to grant such protection.

Cases which dealers may have won in district courts, however, are often overturned by courts of appeals, leaving the dealer with a bankrupt business and an enormous legal debt.

I can recall a gentleman in Florida who fought for 5 years because of a bad piece of equipment. He is in total bankruptcy. He has lost his family. He is in poverty at this time, even though the settlement was for $5 million. It has been appealed and appealed and appealed. It is not fair to have a multinational company treat an independent businessman in that fashion.

A final option which the dealers, through their association, have tried with no success is to seek and obtain the assistance of appropriate agencies of the U.S. Government. These agencies include: The Federal Trade Commission, the Small Business Administration, and the Office of the U.S. Trade Representatives. They have been of very little help.

We are therefore left with our last option: Legislation to require, once and for all, that office machine manufacturers treat their dealers in a fair and equitable manner.

We strongly endorse the Retail Dealers' Agreement Act, S. 1256. We feel the bill would provide a clear remedy where none now exists to handle disputes, without involving the Federal Government or imposing a regulatory burden on manufacturers.

I think it would be a useful deterrent to continued business practices of manufacturers which are not fair and equitable to the dealers. And still, we would be able to preserve the competition in the marketplace. We could reduce the number of lawsuits being filed by dealers, by eliminating the confusion which has resulted from a lack of standards and from the inadequacy of current law to address office machine dealers' manufacturer problems.

It would enhance competition in the small business community by strengthening the dealers' credibility and financial stability in the marketplace, as he is given an incentive to invest in his business. I think it would allow the dealers to continue their current

relationships with those manufacturers where there are good contracts, if they so wish.

I think we draw on a precedent established by the Automobile Dealers' Day in Court Act, but would not seek to speak for other industries in which the dealer/manufacturer relationships may exist. It would not require a manufacturer to continue supplying a dealer who does not perform.

I think we would be able to treat foreign firms no less favorably than the domestic manufacturer. As you have seen, and will see from my colleagues, all problems are real and they are serious.

Independent dealers, small businessmen, and end-users in the United States are being victimized through these unconscionable business practices. Dealers are forced to bargain from weakness and dependence and an absence of good faith. Unreliable products are being imported and sold on the basis of manufacturers' false product claims. And finally, dealers are required to make a substantial investment without adequate protection for their small businesses.

Now, I understand, Mr. Chairman, that there is some concern and there will be testimony a little later—but let me make it crystal clear that in your bill, S. 1256, only can office machine dealers seek redress under the provisions of the bill. The International Franchise Association may have some problems with it, but we have sought to, work out acceptable definitions, in the spirit of cooperation, and we will continue to do so.

It is curious that we have no manufacturers who intend to appear here today. There are some concerns in our regard—and I think this is indicative of the fact that they have stonewalled. They will not come to the bargaining table. They do not want to discuss the need of the independent dealer in this country.

I do not believe that this bill is precedent-setting. We have the Automobile Act. We have the Bottlers' Act, the Petroleum Marketing Practices Act. And I believe there is also the Malt Beverage Act that is currently being considered in Congress.

We need relief. The association now seeks the assistance of Congress to aid us in attaining our objectives.

And on behalf of our members and myself, I sincerely thank you for your time this morning.

I would be happy to answer any questions that you may have for me.

Senator PRESSLER. Thank you very much.

We shall hear each witness' opening statement, and then we shall ask several questions of all of you. And if portions of your testimony have been covered, you might summarize, to save time.

We will have quite a lengthy questioning, but I want to hear from each of you. If we could have approximately 5 minutes from each, or thereabouts, that would be most helpful.

Mr. VAN GELDER. May I request that my full statement be submitted for the record?

Senator PRESSLER. Without objection, that is so ordered.

[The statement follows:]

STATEMENT OF TOM VAN GELDER, IMMEDIATE PAST PRESIDENT, NATIONAL OFFICE MACHINE DEALERS ASSOCIATION

My name is Tom Van Gelder, Immediate Past President of the National Office Machine Dealers Association, a non-profit organization of over 5,000 member owners of independent office machine companies, most of which are family-owned. Our members are located in each of the 50 states of the United States as well as ten foreign countries. These independent dealers work together in a common effort to educate each other in the latest management, marketing, and technical procedures so that they can best run and operate their individual small businesses.

Our membership is comprised of some 5,000 dealerships, representing at least 70 percent of those independent dealers which primarily market office machines, although many also offer lines of furniture and other office supplies. These businesses carry lines of products which include copiers, computers, typewriters, electronic cash registers, desktop calculators, dictating equipment, word processors, addressing equipment, checkwriters, offset printers, duplicating machines, letter openers, shredders, telephone equipment, data processors, labelers, scales, lettering machines, collators, staplers, laminators, microfilmers, microfiche units and many other products.

NOMDA's benefits to the industry are recognized worldwide. The association's programs in the areas of dealer education, international relations, government relations, publications and scholarships as well as general assistance to its dealer members are invaluable tools for developing the independent dealer's approach to the marketing of his products and the organization of his business. Exhibits, education and exchange of ideas are combined to create the annual National Office Machine Dealers Association Convention and Trade Exposition. This convention, attended by over twenty thousand individuals, is one of the largest trade shows in the United States, and provides a comprehensive exhibition of the most advanced products and the latest technology in the industry. The exposition provides dealers with a unique opportunity to view and examine new products from over three hundred domestic and foreign manufacturers in one convenient forum. At the Annual Convention in Las Vegas last month, there were over 1,000 exhibit booths.

Let me emphasize that our association's officers and committee chairmen are all small businessmen and businesswomen who have volunteered their time and ideas to strengthen our industry through NOMDA. They have risen through the ranks and, therefore, represent our membership in a very direct sense.

Our industry has experienced incredible change over the years, and NOMDA has been quick to react. In the early 1970's, with the rapid introduction of foreign products into the office machine industry, NOMDA began a concentrated effort to improve international relations through the formation of the International Relations Committee. This committee maintains contact with the many foreign manufacturers of business equipment marketing through dealers in the U.S. It watches for trends overseas that could affect the marketing of machines in the U.S. and encourages the interchange of information with office machine dealers worldwide. NOMDA has successfully conducted educational seminars for the benefit of office machine dealers in Great Britain and Canada. Furthermore, it encourages close working relationships with other associations representing specific segments of our industry including cash registers, copiers, computers and others.

How does the small independent office machine dealer fit into the overall economy of the United States? Traditionally, the large domestic manufacturers of office equipment, whose names have become synonymous with the industries they dominate, have marketed their products directly through their own individual sales forces. Some of the companies which have chosen the direct approach include Xerox, IBM, NCR, Texas Instruments and so on. As you might well imagine, the sales forces within those corporations are fairly sizable, and dealer competition with them is considerable.

However, most manufacturers of office equipment have seen the advantages of marketing through a network of independent dealers located in every state and locality in the country. These dealers have close relationships with other small businesses and consumers in their respective market areas. They can market a wide range of product lines, although their choice of products is often governed by manufacturer marketing strategies for the area concerned. Some dealers carry only office machines, some only office furniture, some only office supplies and some any combination of these. Our main concern, however, is office machines.

Technologically advanced, high priced office equipment has traditionally been the exclusive domain of the large manufacturers selling through branch offices. On the other hand, the independent office machine dealer in the past has limited his involvement to the less sophisticated, less costly products. In the last decade, howev-

er, more and more dealers, using their traditional typewriter/calculator businesses as a foundation, have expanded into such high technology areas as word processing and mini-computers, adding photocopiers to their line of products along the way. By selling their knowledge and service capabilities, these dealers have proven they can compete effectively against the major manufacturers using a direct sales force. Recently, in fact, some of these manufacturers, including Xerox, have decided to experiment with the proven dealer approach to try to boost sales. We believe these moves are simply another indication that marketing through dealers is the best route to higher sales and better service.

As Senator Exon, who is a former office machine dealer, knows, today's dealer has some very unique characteristics. First, he is a sophisticated businessmean bearing very little resemblance to the mom and pop operations of yesteryear. He has a firm understanding of all phases of business, and boasts a proven track record managing a complex business in one of the most demanding, dynamic industries in the world. Second, he has a vested interest in his company. With his own capital invested in his business, the dealer works harder to ensure the success of his business, and this success can only be achieved if his customers are satisfied. Third, he has a permanent commitment to his business and community, with accountability on the local level. The dealer represents a permanent contact for the customer, in contrast to the branch manager of the giant manufacturers whose goal is to be promoted to greener pastures; or the supplier, who has no contact with the end-user and leaves customer satisfaction to the independent dealer. Fourth, he is personally committed and involved, knowing that he must relate to his customers on a person-to-person basis, as well as on a company-to-company level. Although the hardware and software in this system are important, it is the "peopleware" that determines the level at which the customers' needs are satisfied. Fifth, the dealer is a problem solver, not a product provider. Rather than being married to one manufacturer's product, he represents a mix of manufacturers, prescreening and selecting only those that can be blended to provide appropriate equipment for his customers' needs. Sixth, he is flexible. The dealer does not have to adhere to rigid restrictions or firm policies established by "the home office in New York". He makes all the decisions right at the local level, meaning that he can respond rapidly to changing market conditions or to specific customer needs. Seventh, the independent dealer is a professional. He takes advantage of a wide variety of educational sources available to him; he learns from the manufacturers he represents; he attends trade shows, seminars, and conventions; and he reads available trade publications. He is educated, not indoctrinated. In general then, today's dealer represents a refreshing alternative to the large impersonal branch operation, and he clearly recognizes that his customers are his most valued assets.

With these qualities in mind, let me take this opportunity to describe to you our typical member. He is a small, independent businessman, probably carrying on in the footsteps of his father and his grandfather before him. His family may have been a fixture in the community anywhere from fifty years onward. The typical gross sales volume of our members averages in the range of $500,000 to $1,000,000 per year. The organization usually numbers about ten employees, a few of which are devoted to the sales of the products, but the majority of which are dedicated to service and customer satisfaction for those products.

The independent dealer, in developing the right mix of manufacturers he wishes to represent, can choose from among many, but, increasingly, they are of foreign origin, particularly Japanese. As far as the dealer is concerned, there are only a very few U.S. companies producing office machines which are competitive with foreign firms in today's marketplace. Some of these foreign companies are European, including Adler-Royal, Facit, Hermes, Olivetti, Olympia and a few others. However, Japanese firms now provide the majority of dealers' product lines. These firms comprise such giant companies as: Canon, Konishiroku, Mita, Minolta, Ricoh, Savin, Sharp, Silver-Reed, Sony and Toshiba, just to name a few.

Incredibly, the problems which my colleagues will discuss today did not even exist ten years ago. Our association is honored that many of its members have gone on to serve government in various capacities. We are most proud of Senator J. James Exon of Nebraska, who formerly was an office machine dealer in Lincoln. In 1970, when Senator Exon sold his business, he did not carry a Japanese product in his store, only because they had yet to enter the marketplace. However, today that same business attributes more than fifty percent of its revenues to Japanese products.

The entry of the Japanese in the office machine industry has had the effect of virtually eliminating American companies as a factor in dealer-sourced business, particularly in the eyes of those customers seeking lower volume, less costly machines. Not unlike our country's dependence on foreign oil, dealers today must look

beyond our borders for viable products to market. In 1979, impots of business machines and parts from Japan alone totalled more than $1,000,000,000. Moreover, more than 70 percent of such products as photocopiers, duplicating machines, electronic cash registers, desktop calculators and non-portable typewriters handled by dealers come from abroad.

In the case of photocopiers, the Japanese entry into the U.S. market was a direct result of a void created by the industry giants. Small businesses could not afford large volume, high cost copying machines for their minimal use. Realizing this vacuum, the Japanese and European firms began developing attractive, low cost machines for small volume use. The first wave of these with their flashing lights, pretty colors, and fancy buttons flooded the country before their designs had even dried on the drafting tables. Realizing that innovations and new features were vital to maintaining a competitive edge, the manufacturers began to introduce new products as rapidly as possible, leaving final product testing to be done in the end-user's establishment. To carry out this marketing strategy and at the same time minimize capital expenditures, the foreign firms looked for an existing marketing arm in the U.S. The independent dealer, who had previously demonstrated his abilities with typewriters and calculators, was the logical choice. In addition, dealers had already established service organizations, an extremely costly venture for a foreign manufacturer.

Over the past several years, such efforts by the Japanese manufacturers and some others have served to create for them quickly and relatively inexpensively, a significant asset position in the U.S. marketplace. It has been accomplished by means of a unique combination of product innovation, rapid introduction of products into the market and competitive pricing. However, without the aggressive marketing and reliable service of the independent dealer, their success would not have even approached the level they currently enjoy. The resulting dependence of dealers on foreign products without alternative sources of supply has allowed these manufacturers to acquire inordinate bargaining power.

Let's look at the independent dealer for a minute. By the time a dealer is successful, he has often invested considerable sums in his business, not all at once, but over a period of time. Typically, he purchases his products on net 30 days financing. All product warranties are transferred to him, obligating him to maintain sophisticated, up-to-date service facilities necessary for end-user satisfaction. A lease on a building, personnel and training, advertising and many other costs comprise a major expense for the dealer. Furthermore, he has the additional responsibility of paying bills as agreed, meeting established quotas, promoting the name and good will of the manufacturer and treating the supplier in a fair and equitable manner. The dealer, then, has much at stake as he seeks to develop his business.

This said, the full picture is set. In an environment in which a relatively few, mostly foreign, manufacturers control a substantial share of the marketplace, the major office machine suppliers, particularly the Japanese companies, secure in their markets and dominance over the dealers, have begun to treat their dealers unfairly. They have full knowledge that their dealers' options are severely limited, and exploit that knowledge to the hilt. What's more, fair treatment entails costs, and it is not required by law. On the other hand, the small dealer has over time committed a substantial investment of money to his office machine dealership, and he has made a name for the manufacturer. However, with limited bargaining power against the big firms, he has no way of protecting this asset which a supplier can destroy at the drop of a hat through termination or non-renewal. What's worse, even success is not adequate to make this asset grow and prosper, as the supplier will often seek to use that success to further solidify its position in the marketplace at the dealer's expense.

Given the context of unequal bargaining power between dealer and supplier, the problems I have alluded to above can be generally categorized as follows:

1. LACK OF GOOD FAITH BY MANUFACTURERS VIS-A-VIS DEALERS

Arbitrary establishment of usually unrealistic sales quotas and their use in a coercive manner; offering no compensation for name recognition or goodwill when a dealer is terminated;

2. LACK OF INCENTIVE FOR MANUFACTURERS TO NEGOTIATE IN GOOD FAITH ON SERIOUS PROBLEMS OF PRODUCT RELIABILITY

Doing nothing to rectify inadequate field-testing of new products; delays in parts supplies; false product claims and coercive practices regarding servicing requirements;

3. SATURATING A MARKET AREA WITH NEW DEALERS WHEN IT IS UNWARRANTED

Arbitrary terminations or non-renewals; and unfair competition by the establishment of wholly-owned retail outlets in existing dealers' market areas.

Other witnesses will discuss these problems areas in greater detail. However, let me explain what we, as dealers, have done to try to put an end to these unfair manufacturer practices. In this way, you can better understand why a legislative remedy is the best, if not only, solution to our problem.

We are very proud of our Model Dealer Agreement which we have suggested that dealers review for guidance when entering into a relationship with a supplier (Exhibit A). The NOMDA Model Dealer Agreement provides that (1) both the manufacturer and dealer will treat each other in a fair, equitable and ethical manner; (2) that the agreement is open-ended, or in other words, continues indefinitly as long as both parties meet their obligations; (3) that sales quotas or standards of performance are mutually agreed upon by the parties as reasonable goals; (4) that problems which develop are resolved through an inexpensive appeal board or arbitration proceeding. If these concepts can be formalized between the parties, then our association and members feel the relationship is on a sound foundation.

Unfortunately, the vast majority of our manufacturers will not state in their agreements that they will treat a dealer in a fair and equitable manner, nor do they have any intention of even discussing the remaining points of the Model Agreement.

As a matter of fact, in a recent meeting with a large plain paper copier manufacturer whose name is well-known in this country, we were told bluntly and unequivocably that this supplier did not intend to give dealers fair and equitable treatment, but would continue to make sure "things go our (the manufacturer's) way". Many other manufacturers would agree with this statement, but simply never say it out loud. I am sorry to say that this attitued is widespread, as few office machine manufacturers have adopted NOMDA's Model Dealer Agreement. To overcome this reluctance, NOMDA, for the past three years, has sent delegations to Japan to discuss with foreign manufacturers why their American distributing subsidiaries should be using the Model Dealer Agreement. In addition, the complaints I mentioned a minute ago were raised as explicitly as possible. Despite repeated assurances and promises to look into the problems we have specifically documented, very little action has been taken by the manufacturers. After three years of all talk and no action, it seems that their response is clear.

You are probably asking yourselves why dealers have not taken action in the courts to redress their grievances. Certainly, contractual disputes in the past have usually been resolved in such a fashion. Dealers have sought relief in the courts. Unfortunately, because of the unilateral nature of many dealership agreements, which manufacturers, wielding their considerable bargaining power, have imposed on their dealers, the dealers have found that their interests are not sufficiently protected by such agreements and, furthermore, that the courts are reluctant to go beyond them to grant such protection.

Moreover, the relevant provisions of common law as well as federal and state statutory laws are not sufficient to give dealers relief from the abusive practices of manufacturers. Numerous dealers have filed suits charging suppliers with violating the Sherman and Clayton Antitrust Acts as well as applicable state laws dealing with fraud and deceptive business practices, with very little success. Cases which dealers may have won in district court, however, are often overturned by courts of appeals leaving the dealer with a bankrupt business and enormous legal debts. Many office machine dealers have even chosen to go out of business rather than risk the expense of a court battle seeking relief under laws which do not address the dealer-manufacturer problem.

A final option which dealers, through their association, have tried—with no success—is to seek and obtain the assistance of appropriate agencies of the U.S. government to focus on the problems which I mentioned before. These agencies include the Federal Trade Commission, the Small Business Administration and the Office of the United States Trade Representative. Senior officials at the FTC, including its past chairman, informed us that the FTC Act was not designed to solve problems affecting small businesses unless there was a significant impact on consumers. Furthermore, the FTC Act does not provide for a private right of action. The SBA assured NOMDA that its responsibilities included protecting the rights of small businesses, but that its assistance would be investigative at best. Finally, the U.S. Trade Representative's Office explained to us that it had no statutory authority to make representations on our behalf to the Japanese and European governments which regulate the activities of the foreign manufacturers in question.

We are, therefore, left with our last option—legislation to require, once and for all, that office machine manufacturers treat their dealers in a fair and equitable

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manner. We strongly indorse the Retail Dealers Agreement Act (S. 1256) as a measure to assure the dealer an opportunity to secure a judicial determination as to whether an office machine manufacturer has failed to act in good faith in complying with any of the provisions of his dealer agreement or in terminating, cancelling or not renewing the dealer.

We feel the bill would:

1. Provide a clear remedy where none now exists to handle disputes, without involving the federal government or imposing a regulatory burden on manufacturers;

2. Be a useful deterrent to continued business practices of manufacturers which are not fair and equitable to dealers, while preserving competition in the marketplace;

3. Reduce the number of lawsuits being filed by dealers by eliminating the confusion which has resulted from a lack of standards and from the inadequacies of current laws to address office machine dealer-manufacturer problems;

4. Enhance competition in the small business community by strengthening the dealer's credibility and financial stability in the marketplace as he is given an incentive to invest in his business;

5. Allow dealers to continue their current relationship and contracts with manufacturers, if they so wish;

6. Draw on a precedent established by the "Automobile Dealers Day in Court Act" (15 U.S.. §§ 1221-1225), but would not seek to speak for other industries in which dealer-manufacturer relationships may exist;

7. Not require a manufacturer to continue supplying a dealer who does not perform;

8. Treat foreign firms no less favorably than domestic manufacturers.

As you have seen and will see from my colleagues, our problems are real and serious. Independent dealers, small businessmen and end-users in the United States are being victimized through these unconscionable business practices. Dealers are forced to bargain from weakness and dependence in an absence of good faith. Unreliable products are being imported and sold on the basis of manufacturers' false product claim. Finally, dealers are required to make substantial investments without adequate protection for their small business. The Association now seeks the assistance of Congress to aid us in attaining our objectives. On behalf of our members and myself, I sincerely thank you for your time this morning and would be happy to answer any questions that you may have for me.

QUESTIONS OF SENATOR EXON AND THE ANSWERS THERETO

Question. 1. Do Japanese manufacturers now have the capacity to market their products on their own?

Answer. In all probability, the largest Japanese manufacturers now have the capacity to market at least some of their products directly. However, I seriously question whether it would be commercially feasible for any manufacturer to do so. The expense and effort required to establish a direct sales force would be staggering. Moreover, as I mentioned in my testimony, the advantages of an independent dealer network are significant. These advantages have been instrumental in the rapid growth of the industry and still exist today. Even Xerox has decided to market its smaller systems through independent dealers.

The typical pattern for these manufacturers has been to use independent dealers to build name and product recognition in a market area. Customarily, only when that has been accomplished will a manufacturer step in with a direct sales outlet, either by terminating their existing dealer(s) or competing directly with him. In doing so, the manufacturers reap the benefit of all the dealer's efforts and goodwill in its behalf without any of the financial risk accompanying those efforts to build up that market in the first place.

Question. 2. What traditional remedies can a dealer pursue if he has been unfairly treated by the manufacturer?

Although I am not a lawyer, I have been advised that there are no currently existing legal remedies to correct the abuses you have heard about today. Dealers have been unsuccessful in utilizing the federal antitrust laws (in fact, I know of many dealers who have been dissuaded by their lawyers from even commencing such suits). State law claims have been equally unsuccessful.

Section 1 of the Sherman Act would appear to be the most likely avenue for dealer relief; however, in the vast majority of cases of manufacturer bad faith, there have not been the blatant per se violations to sustain a restraint of trade charge. In any event, even termination without cause is not an antitrust violation. See, *Burdett*

Sound, Inc. v. *Altec Corp.*, 515 F.2d 1245, 1249 (5th Cir. 1975). Section 2 of the Sherman Act, which has never been used successfully, does not even purport to speak to the bulk of bad faith cases, and only might be applicable when the manufacturer attempted to eliminate all its dealers to monopolize distribution. Suits under Sections 3 and 7 of the Clayton Act have been attempted by terminated dealers (in other industries) without success. Equally unavailing is Section 2(a) of the Robinson-Patman Act.

State laws have proven to be of little use. Few states have their own antitrust laws; even in those that do have such laws, the unhelpful federal precedent is followed. Also, some states have passed, "little FTC Acts". To date, no terminated dealer has successfuly utilized these acts in seeking redress against unjustifiable termination. State contract law cases show a similar lack of success; although in a few states, certain dealers in other industries have received favorable opinions, but only in the most blatant cases. Indeed, courts have held that the UCC "unconscionability" and "good faith" provisions, which are at the heart of S. 1256, only apply to "transactions in goods", not to business or trade practices even in termination cases. See, *Zapatha* v. *Dairy Mart, Inc.*, Mass. Adv. Sh. 1837 (1980). Of course, in cases where there is no written contract, state courts have routinely thrown out suits based on the Statute of Frauds.

Question. 3. Could dealer problems with manufacturers be resolved in arbitration outside court?

Answer. The NOMDA Model Dealer Agreement, which imposes on both parties the obligation to behave fairly and equitably towards each other, contains an arbitration provision for the resolution of disputes outside of court by an Appeals Board. Manufacturers who refuse to sign the Model Agreement also refuse to arbitrate. From their standpoint, why should they? Manufacturers know they now hold all the chips, and arbitration would be a threat to their position of total domination of dealers. I should add that arbitration alone is not sufficient. Without a clear delineation of a standard of conduct required from both parties, the basis of an arbitrator's decision could be unclear. S. 1256 is required so that both dealers and manufacturers know the standard to which they must adhere and, thereby, significantly decrease the number of disputes. The Act would create a strong incentive to arbitrate disputes which did arise so as to avoid unnecessary lawsuits under it.

Senator PRESSLER. I next call upon John Kuchta.

STATEMENT OF JOHN J. KUCHTA, VICE PRESIDENT, LINCOLN OFFICE EQUIPMENT CO., LINCOLN, NEBR., AND TREASURER OF THE NATIONAL OFFICE MACHINE DEALERS ASSOCIATION

Mr. KUCHTA. I have been looking forward to sitting before my former competitor, Senator Exon. He was an office machine dealer, a worthy competitor in Lincoln, very successful small businessman in Lincoln, before ascending to State and national office.

I am vice president of Lincoln Office Equipment. I also hold the office of treasurer for the National Office Machine Dealers Association.

Lincoln Office Equipment is a family-run business. I, like my father, am working in the business. Our business could be categorized as larger than average, with approximately 50 employees.

I am here today to discuss the problems facing the office machine dealer. In the interest of time, I would like to highlight my written testimony.

I would also like to request, Mr. Chairman, that my full statement be submitted for the record, as well.

Senator PRESSLER. Without objection, that is so ordered.

Mr. KUCHTA. We represent domestic and foreign manufacturers—companies such as Victor Business Products, Savin Corp., Lanier, Olivetti, Canon.

There are specific problems that are plaguing our industry today. Manufacturers hold a tremendous advantage in bargaining power

over the office machine dealer. As Mr. Van Gelder stated, the typical office machine dealer is a $500,000 to $1 million company. They deal with—in many cases with multibillion dollar corporations. It is very much a David versus Goliath situation.

The manufacturers take full advantage of the situation, and we feel they do not deal on a good faith and fair dealings basis. This lack of good faith shows up in arbitrary termination and nonrenewal of contracts. It also shows up in inequitable actions regarding the distribution and servicing of equipment.

Retrofits, which is a—which is a term that we use in our industry for devices that are put on pieces of equipment to make them run better—in many cases because of the technological changes in our industry, the manufacturers rush to get a product to market without adequate field testing, and thus the retrofits are necessary. The problem is that the office machine dealer is responsible for all labor involved in putting those retrofits in place.

Harsh actions in placement of new dealers and manufacturer-owned branches within the dealers' sales area is another area in which we want to seek relief.

S. 1256 equalizes this disparity in economic power by bringing the concept of good faith into the manufacturer/dealer relationship. Good faith is the key element of the bill. Fair and equitable treatment is what we are seeking.

If the manufacturer treats the dealer on a fair and equitable basis, the office machine dealer in turn has to treat that manufacturer the same way. We can develop good arm's length dealing.

Because of the unequal bargaining power that I mentioned earlier, coersion and veiled threats are paramount. Good faith standard is flexible. It is well known to legislators such as yourself, Mr. Chairman, and Senator Exon, and I think it is specific to provide a standard for this bill.

Bad faith on the part of the manufacturers is too numerous to discuss today, but let me give you an example—a personal example:

In 1979—as I mentioned, I am a Savin dealer—Savin sent a letter and a contract to my office. The letter stated: "Please read the contract, sign it, and return it" by a specified date, "unchanged, unmodified. If you don't do that, we cannot ship you any more product."

The dealer, myself—I had a vested interest to service my customers. I have a commitment to my community, to treat my customers fairly and equitably. I had a choice between signing the agreement as it was presented, or going out of business. Not much of a choice.

That contract, which stated that it was in the long-term best interests of both myself and of my company, has a 30-day cancellation provision without cause; 30 days—they can cancel me. They can change the method of distribution without notice. If they want to put in a factory-owned Savin branch store, they can do that, no problem.

In essence, the dealer builds the business and the potential exists for the dealer to turn over that business to Savin. If I was canceled or terminated, my sales and service records have to be turned over to Savin, based upon the agreement.

Once again, the dealer builds the business and turns it over to Savin. It is a large investment. Lack of compensation for building an asset is inequitable, as far as I am concerned. Failure to comply with the results, or failure to comply with the agreement is subject to automatic entry into an injunction by that dealer. So, if we do not comply to the agreement we automatically enter into an injunction.

The dealer agrees to pay maximum attorney fees as part of the agreement. The Savin agreement is not fair and equitable. It is preditory and harsh. They have not demonstrated good faith. And the agreement, illustrates this graphically.

When one party holds all the chips, it is pretty difficult to negotiate. This type of manufacturer/dealer relationship is not in the best interest of the end user. Our primary goal—my primary goal today, in talking to you, is to create and preserve my family business, my small business.

Most manufacturers also have finite term agreements—1-, 2-, 3-year contracts—so it is a new ball game every time the contract comes up for renewal. No requirement to act in good faith or good will, and the manufacturer can terminate you. It is not costly or difficult for the manufacturer today to say: "Thank you for establishing the business. Now we're going to set up our factory-owned store."

Without S. 1256, dealers really have no remedy, judicial or otherwise, to combat this gross inequity.

In summary, S. 1256 establishes a standard of good faith to govern manufacturer treatment of dealers and vice versa. It helps dealers to bargain more equally, more equitably. It makes it possible to be compensated for the good will created and, in cases of termination or nonrenewal, it allows dealers to reap the benefits of the market area they invested in.

S. 1256 will aid end users, and it will also help strengthen small businesses.

Thank you, Mr. Chairman.

Senator PRESSLER. Thank you, John.

Mr. KUCHTA. Thank you.

Senator PRESSLER. It is good to have some actual businessmen, as we have here today, to give their views to us.

[The statement follows:]

STATEMENT OF JOHN J. KUCHTA, TREASURER, NATIONAL OFFICE MACHINE DEALERS ASSOCIATION

Good morning. My name is John Kuchta, Vice President of Lincoln Office Equipment Company in Lincoln, Nebraska. I also hold the position of Treasurer in the National Office Machine Dealers Association, one of four national officers. I have been looking forward to this opportunity to sit before my former competitor, Senator Jim Exon, who was a very successful office machine dealer in Lincoln before he ascended to state and national office.

Lincoln Office Equipment has been in business for twenty-five years. I have, like many office machine dealers today, followed in my father's footsteps to take up his role as a reliable supplier of quality office machine products and service to end-users in our community. I carry a fairly wide range of products, including copiers, typewriters, calculators and word processing equipment. I represent both foreign and domestic manufacturers, such as Canon, Minolta, Savin, Olivetti, Victor and Lanier. Compared to other office machine dealerships around the country, my business in terms of size could be characterized as larger than average. I have 55 employees.

Let me put on my NOMDA officer hat for a minute so that I can make some observations about specific problems plaguing our industry. The preceding witness, Mr. Tom Van Gelder, presented some very clear trends indicating that office machine manufacturers over the past few years have been taking unfair advantage of their considerable edge in bargaining power over the dealer. Specifically, the manufacturers have been guilty of lack of good faith in their treatment of dealers, which manifests itself in, among other things:

Arbitrary actions regarding termination and non-renewal of contracts with existing dealers;

Inequitable positions regarding the distribution and servicing of products; and

Unreasonably harsh actions in the placement of new dealers within existing dealers' market areas.

All of these actions have been undertaken in a high-handed, usually coercive manner, because manufacturers are clearly aware that a dealer has no alternative to their demand other than going out of business. The purpose of S. 1256 is to eliminate this inequity and, thereby, strengthen the office machine industry and benefit the end-user. One of the primary effects of this gross disparity in bargaining power has been the repeated frustrations of the reasonable commercial expectations of the dealer when he enters into a relationship with a manufacturer.

The Retail Dealers Agreement Act embraces, as its cornerstone, the imposition of a good faith standard on both manufacturers and dealers. I would like to elabrate for a few minutes on the concept of "Good Faith" to which we have been alluding. The phrase plays an important part in office machine manufacturer-dealer relations. The bill defines "Good Faith" as "the duty of each party to any dealer agreement, and all officers, employees, agents, of other representatives thereof, to act in a fair, equitable (and ethical) manner toward each other so as to guarantee each party freedom from coercion, intimidation, fraud, or unconscionable conduct by the other party."

The good faith test is particularly useful in solving the problem facing the office machine dealer. In the first place, it is a concept familiar to legislators and courts in many areas: from the 25-year old Automobile Dealers Day in Court Act to labor laws to basic tenants of contract law. Specifically, good faith is sufficiently flexible to provide a remedy for the pervasive excesses of manufacturers who, insulated by the manifest disparity in bargaining power, have not been compelled to bargain or act in good faith. These abuses take many forms and, of necessity, must be treated on a case-by-case basis.

Establishing a laundry list of prohibited and permitted actions would be counterproductive. On the one hand, no list could cover all the possible forms of abuses; furthermore, loopholes can easily be devised in even the most comprehensive list to defeat the intention of the legislation. On the other hand, such a detailed approach could constitute an unduly restrictive burden on the daily business life of manufacturers. We do not seek to tell anyone how to run his business, only to establish the outer boundaries. S. 1256 will establish the basic principles upon which both manufacturers and dealers can base their actions without significant incursions into the day-to-day decision-making process.

The "good faith" test would not, however, be overly vague. As I mentioned a minute ago, courts have been interpreting good faith in a variety of contexts for many years. We believe that it is vital to continue the development of a practical standard of good faith that reasonable businessmen can use in their arms-length dealings within the commercial reality they both face.

A useful specific example is the Automobile Dealers Day in Court Act, which uses a very similar definition to the one in S. 1256. Over twenty years of case law indicate that courts have had no difficulty in defining "good faith" within the context of each case presented to them under this statute. Moreover, I don't think anyone would seriously argue that good faith is not an appropriate standard on which to base business dealings.

While the examples of manufacturers' bad faith and unconscionable activity are many and varied, two of the most egregious examples are virtually universal practices. First, dealers all over the country are intimidated or coerced, either tacitly or overtly, into signing contracts with suppliers without being allowed to even negotiate any of their terms. Of course, the suppliers in most instances are too sophisticated to make blatant threats, which are often subtle or couched in non-threatening language. Nonetheless, the threats are real: if a contract which a supplier states has to be returned by a certain time unchanged is not so returned, the dealer may face termination in exactly the same fashion as if the threat of termination had been explicit. Let me give you a specific example.

I am a Savin dealer and have been for eleven years. As most of you know, Savin is an office machine manufacturer marketing Japanese plain paper copiers pro-

duced by Ricoh Business Machines Ltd. Mr. Van Gelder made reference in his testimony to Savin's policy toward treatment of its dealers, and to its apparent intentions not to be fair and equitable.

This very clear statement of Savin's position provides real meaning to a letter and contract first sent to Savin dealers in 1979, which pays nothing more than lip service to the concept of good faith. The letter (Exhibit A) speaks of a "fair and competitive agreement" that is "equitable" and "in the dealers' long term best interests." The agreement however "cannot be modified" making it impossible for the dealer to raise what he, in fact, views as his own best interests. He is instructed to sign and return the agreement "unmodified" no later than a specified date; otherwise his orders will not be processed.

The Savin Corporation Dealer Agreement does little, if anything, to promote fair and equitable treatment of dealers. By its terms, Savin refuses to stand behind its products or its dealers. There is no recognition of the dealer's efforts in building the market for Savin products. Instead, paragraph 10 provides that Savin may terminate the agreement without cause on thirty (30) days' notice. No notice is needed it Savin decides to change its distribution system (by dropping all dealers, for example) or to issue a new dealer agreement. After termination (paragraph 12), the dealer is only entitled to compensation for his new, unused inventory and any special Savin tools he has purchased. He gets nothing for goodwill and not a penny for the rest of his inventory, even at fair market value. The dealer faces numerous obligations on termination, including assigning all his current sales to Savin and returning parts, books and service manuals. If he wished to service the Savin products he sold, he would have to buy the manuals. If the dealer fails to comply for any reason, the contract he is required to sign indicates that he consents to an entry of an injunction against himself. He also further agrees to pay maximum attorney fees allowable. Rather than demonstrating good faith, fair and equitable dealing between dealer and supplier, the Savin agreement is predatory and arbitrary, graphically demonstrating the unconscionable activity possible when one party has all the chips.

Let me say a few words regarding the second major example of the manufacturers failure to act in good faith, to which I have just alluded, and which occurs in the context of a termination or non-renewal of a dealer's contract. Manufacturers have consistantly refused to even recognize a dealer's right to compensation for the goodwill he has generated in building and running his business. As you know, goodwill is a valuable asset, one derived from a business' reputation for quality and service. It is intimately associated with continuing favorable customer patronage and based on the length of time the business has been in existence, its average profits and its success. Goodwill is perhaps the most accurate reflection of a business' value as a going concern.

A dealer, who has built up his business, established a reputation for himself and the products he carries has generated an asset of great value not only to his business, but to the manufacturer's product line as well. The inequity of allowing a supplier to terminate or fail to renew a dealership without compensation for goodwill is doubly harsh when it is realized that not only is the dealer deprived of the value of an asset (e.g., the dealership goodwill), but the manufacturer, by selling directly or appointing a successor dealer, is effectively stealing an asset (e.g., the goodwill toward the product) the dealer created.

I cannot emphasize enough that one of an office machine dealer's primary goals is to create and preserve an asset in his business, an asset which he can nurture and pass down to his children and his children's children. Unfortunately, many manufacturers use exclusively finite-term contracts (one, two or three years), which makes it possible to terminate or not renew dealers, often without cause. Moreover, with no requirement to act in good faith by compensating dealers for goodwill, termination or non-renewal is neither costly nor difficult. Without S.1256, dealers simply have no remedy, judicial or otherwise, to combat this gross inequity.

By making it a violation of federal law for an office machine supplier to fail to act in good faith in living up to the terms of a dealer agreement, we foresee dealers finally having an opportunity to attack problems which result from the manufacturer's overwhelming superiority in bargaining power and which seriously erode the dealership's competitiveness, such as:

1. Manufacturer's establishment of arbitrary and unreasonably high sales quotas, without any dealer input;

2. Not compensating dealers for retrofits, which are improvements after sale to the end-user, required to correct defects;

3. Refusing to reduce often considerable delays in the supply of parts, schematics, reference manuals and other product related material needed by all dealers to support sophisticated office machinery.

As long as manufacturers can protect their unequal bargaining position and avoid the obligations of good faith dealing, then these problems will not only remain but worsen.

A second major problem area for office machine dealers is a growing fall-off in the reliability of the products we sell. The nature of the office machine industry in the 1980's is quite different from that of the 1960's and before. Senator Exon would probably be surprised at the degree of technological advance which has occurred since he was in business a decade ago. The number of highly-sophisticated products now on the market is staggering. They require careful maintenance by skilled technicians schooled in the latest developments in microelectronics, data processing, communication and photo reproduction. A dealer's service personnel must be continually involved in training so as to be able to handle the rapid, virtually non-stop introduction of products and innovations in the marketplace.

In such an environment, pressure on the manufacturer to produce and market quickly a competitive product is unrelenting. Coupled with an ability to pass all warranties on to the dealer and to move to other dealers if necessary, the manufacturer is free and clear to produce a product, factory-test it quickly (while avoiding testing in the field under normal conditions) and market it through a dealer, who is required to maintain the product at his own expense with minimal support from the manufacturer. To go back to the Savin examples, the dealer agreement in Exhibit B provides for a limited warranty to pass to the dealer in exchange for which the dealer must release Savin of any and all claims regarding product performance. By this provision Savin indicates it will not stand behind its products. Moreover, paragraph 4 indicates that Savin does not make any promises to deliver the product, reserving for itself "sole and absolute discretion" regarding the allocation of its inventory.

As a result of such attitudes, office machine dealers across the country have been increasingly faced with product reliability problems evidenced by:

1. Inadequate field-testing of machines. For example, soon after I had purchased some 200 Minolta copiers (Model 101) and sold them to my customers, I was told that Minolta had upgraded the photoconductor drum, which transfers the image from the original to the copy. Moreover, since the new drum was not absolutely necessary to keep the machine functional, I was charged $175.00 for each "retrofit kit" delivery and compensated nothing for the labor and other expense to perform the installations. Why did I suffer harm to my business and reputation? Because Minolta had failed to field-test and equipment properly before putting it out on the market.

2. Numerous retrofits on machines necessary to allow them to function properly. Minolta, Canon and Savin have all been guilty of calling on dealers to retrofit machines after they have left the dealer's establishment, at great expense to the dealer.

3. Changes in "preventive maintenance" procedures once machines have been sold by dealers to end-users. Last year, Canon sold me a new copier (Model NP 200). The specifications for this machine provided that a preventive maintenance procedure was necessary on each machine in the field every 10,000 copies. I incorporated the annual cost of such requirements in each of my service contracts with my customers. Four months later, Canon informed me that a "pm" was necessary now every 5,000 copies, in effect doubling my cost of service for these machines.

4. False claims by sales representatives of the manufacturers as to product performance. The misrepresentations regarding necessary preventive maintenance, which I just mentioned, are just one example. The Canon sales rep also said the NP 200 had two-sided copying capability. It does not. The Minolta representative assured me that the Model 310 could easily produce 6-7,000 copies per month, but end-users experience has shown that 2-3,000 copies per month is closer to its capability.

Such practices as the ones I have outlined not only hurt dealers but consumers as well. Dealers and end-users should not have to suffer financial loss and other damage at the hands of office machine suppliers nor shield manufacturers from the need to produce reliable, safe products.

A third major issue of vital concern to office machine dealers is the way in which manufacturers dilute the existing dealer's principle sales area. Manufacturers accomplish this dilution in two ways: by establishing other dealers in close proximity to existing dealers, and, even more pernicious, by creating in such areas direct retail sales operations which these manufacturers wholly own.

First, let me say a word about dealer sales or market areas. As in S. 1256, the dealer views his market area as the "dealer's geographic selling area of responsibility as defined in a dealer agreement, or, if not defined in a dealer agreement, the geographic area, within one hundred miles of the dealer's primary place of business in which the dealer principally conducts its business, including, selling the product,

servicing the product, and in other ways satisfying the needs of the end-users of the product". Normally, a dealer will sign a contract with a manufacturer to market a given product or products within a generally defined geographic area. In cases where an oral contract exists, the understanding is verbal only.

Most dealers do not have exclusivity within their sales territories, and dealers, who not only accept but thrive on competition, have no expectations regarding exclusivity. Nevertheless, office machine manufacturers customarily assure new dealers that they will take no action to infringe on their new sales areas. The dealer subsequently expends considerable time, money and effort to promote the name of his supplier and build end-user acceptance and demand for its products. The dealer does so with the expectation that he will be able to take advantage of his success in building product goodwill through increased profitability and growth. The dealer seeks to expand and maintain customer satisfaction as his market and sales grow.

Unfortunately, office machine manufacturers often prefer to set up new dealers where existing dealers have had success. In many cases, the supplier chooses not to market through a dealer at all but to set up a wholly-owned branch operation in a successful dealer's market area. The wholly-owned operation obviously has a significant competitive advantage over the existing dealer whose profitability is severely impaired. Often the heretofore successful dealer is driven out of business.

The dealer has two serious complaints about such practices:

1. The manufacturer sets up new dealers in an existing dealer's market area with no apparent consideration of current economic or marketing conditions in that area, or of the existing dealer's success in providing adequately for the end-user's needs. Usually, the manufacturer is simply seeking "coverage", and sales quotas for the existing and new dealers often rise dramatically to a level that is clearly unwarranted.

2. The manufacturer, while telling its existing dealer that his performance is outstanding, establishes a new dealership or dealerships in that very same market area without notice whatsoever to the "outstanding" existing dealer. Usually, the existing dealer finds out about his new competition from his customers rather than from his supplier.

These situations, which again illustrate a blatant lack of good faith on the part of the manufacturer, have many variations, such as: establishing a new dealer on the fringes of an existing dealer's principal sales area, and at the same time, requiring the new dealer to set up branches much closer to the existing dealer; existing dealers who find their best customers being visited by new dealers accompanied by the manufacturer's sales representative; manufacturer branches competing head-to-head against the company's dealers after a product has been successfully introduced by the dealer and its brand name widely recognized.

In many cases, such actions result in termination or nonrenewal of dealers for failure to meet unreasonably high quotas or for the purpose of eliminating competition with a manufacturer's branch operations. As a consequence, competition is, in fact, curtailed, and customer satisfaction is reduced.

In summary, speaking as an independent office machine dealer and as an officer of the National Office Machine Dealers Association, I wholeheartedly support S. 1256 and urge that it be approved by Congress. Enactment of the bill would, once and for all:

Establish a standard of good faith to govern manufacturer treatment of dealers so as to eliminate threats, intimidation, coercion and other unconscionable actions aimed towards dealers by manufacturers;

Help dealers bargain more equally with their giant manufacturers in the negotiation of reasonable sales quotas and other terms in dealer-supplier contracts;

Make is possible for dealers to be reasonably compensated for the goodwill they generate for a manufacturer, in cases of termination or non-renewal;

Allow dealers to reap the benefits of a market area in which they have invested their time and money, while not unfairly preventing manufacturers from further penetrating growing markets.

As a result, manufacturers will be able to market highly reliable products to increased numbers of satisfied customers, and dealers will be able to profit from their efforts as intermediaries, building an asset in their businesses and strengthening this country's small business community.

I would be happy to answer any questions that you may have.

88-366 O - 82 - 5

[EXHIBIT A]

SAVIN CORP.
Valhalla, N.Y., May 17, 1979.

To: 700 Series Dealers.

We are pleased to announce and enclose the original and one copy of your Savin 700 Series Dealer Agreement for each of your authorized locations. The agreement is the result of out extensive research and study into every aspect of the supplier-dealer relationship to develop a fair and competitive agreement. We are satisfied now that as a consequence of this exhaustive analysis, we have produced an agreement that is equitable and in our dealers' long term best interests.

With the number of dealers we have, it would be impossible to develop a special contract for each dealer; therefore, the enclosed is the standard agreement being issued to the Savin 700 Series dealers and cannot be modified. As you will note, the effective date after execution is as of May 17, 1979. After you have reviewed the enclosures, please sign the original and each copy for each authorized location and return them, using the enclosed envelope, to me in Valhalla, New York, for execution on behalf of Savin. We will return a signed agreement to you for your files.

Because of the legalities involved, a time limit is necessary. Please return all the enclosed agreements, unmodified and properly signed, no later than June 22, 1979; otherwise we will not be able to process your orders for Savin 700 Series Products.

Savin appreciates the efforts you have extended to promote Savin Products, and we look forward to a relationship which will be mutually beneficial and profitable. You may be assured that we will continue to provide the support programs and services best suited to enhance your marketing efforts for Savin copiers.

If you have any questions, please contact your Area Manager.

RODERICK D. MARCOUX,
Vice President/Dealer Operations.

QUESTIONS OF SENATOR EXON AND THE ANSWERS THERETO

Question. 1. Our country is based on the free enterprise system where competition among businesses is encouraged. Do the territorial restrictions in the bill run counter to this?

Answer. The territorial restrictions in S. 1256 do not discourage competition whatsoever. In fact, the opposite should be the case. Our industry, with its recent explosive growth, is unique. Dealers in office equipment today must invest substantial amounts of capital in buildings, inventory, personnel, training, advertising and service capabilities. The products being marketed are more and more sophisticated; they require precise and careful maintenance; and they are much higher priced on a unit basis than even five years ago. Unlike dealers in most other industries, this rise in capital requirements has not been matched by the traditional contractual protections. Therefore, the office machine dealer has much more at risk than ever before. Moreover, the ability of large manufacturers to treat their small dealers unfairly through coercive and other actions makes such dealers even more vulnerable. As I see it, financially secure dealers are capable of being more competitive than weak ones because they can offer lower prices, better service and more flexibility to meet rapidly changing consumer demand.

I wish to stress that the bill contains no provision which would prevent any manufacturer from achieving market penetration through good faith expansion of its distribution network. Moreover, Section 3(a)(4) only calls for a notice of sixty days to existing dealers in a market area when such an expansion is expected; it is not a prohibition. Thus, manufacturers would, in the future, be given an incentive to work with their dealers to meet demand in a given market area, while allowing for flexibility in changing dealers or establishing new dealers or branch operations, if required.

I should point out that often manufacturers have used their bargaining power over dealers to cancel successful ones which have competed effectively against manufacturer wholly-owned branch operations. Competition in these situations has been effectively curtailed.

Finally, in the definition of "market area", the reference to a 100-mile radius is only relevant to those few cases in our industry in which the dealer agreement does not define a "geographic area of primary responsibility". Consequently, the mileage issue is really a very minor one.

Question 2. Should manufacturers of business equipment be allowed to market their own equipment?

Answer. They have the option of doing so now, and S. 1256 would not prohibit such action. However, given the economic realities for most of the three hundred fifity manufacturers now marketing products through dealers, choosing the direct sales approach has hazardous consequences for profitability and sales. The enormous expense of establishing a direct sales force and a service capability nationwide would outweigh virtually all other costs of marketing and servicing the product. So the issue is really not one of choice, but economic feasibility.

It is notable that two giant U.S. manufacturers of office machines using a direct sales force, Xerox and NCR, have recently acknowledged the success of the dealer approach by choosing to set up a limited number of dealers to market some of their products. They are seeking a less costly and more effective way to sell in the marketplace.

Question 3. How can goodwill be adequately measured for compensation purposes?

The concept of goodwill and the traditional techniques of valuing it are intimately familiar to the courts, the Internal Revenue Service and the accounting profession. Thus, its valuation is not a real problem, even though the factors involved cannot be directly traced to specific units on a balanced sheet. However, goodwill is usually defined as transferable expectancy of earnings in excess of the normal return on tangible assets, and turns on several factors, including the length of time a dealer has been in business.

The real issue here is not the illusory problem of how goodwill should be valued but whether a dealer should be compensated for his efforts over a period of years to build name recognition and market demand for a manufacturer which terminates him without good cause. Without compensation for goodwill, the dealer effectively grants the manufacturer an asset for nothing.

Senator PRESSLER. Next I will call on Richard P. Nelson, president of Ohio Business Machines of Cleveland, Ohio, for his statement.

STATEMENT OF RICHARD P. NELSON, PRESIDENT, OHIO BUSINESS MACHINES, INC., CLEVELAND, OHIO

Mr. NELSON. I would like to request that my statement be included in the record.

Senator PRESSLER. It is so ordered.

Mr. NELSON. I have been an office machine dealer for five years, and prior to that, I spent 13 years as a manufacturer. And one of the reasons I am here is to try to lend a little credibility to both sides, because I sat on both sides of the fence.

Before providing specific examples of the problems jeopardizing our industry, I would like to underscore several points made by Tom and John.

The manufacturers' dictatorial power over dealers is a national problem that transcends State boundaries. I have met 3,000 dealers in my activities from every State in the union and the message has always been the same: Manufacturers are guilty of the same practices in Ohio, New York, California, wherever. In fact, I've taught seminars in England and in Canada. The response was the same there about the manufacturer problems.

I think it is a manufacturer problem, rather than a specific State or country problem. Unfortunately, we are not talking about only one or two manufacturers. Virtually all of the overseas manufacturers are guilty of the same practices. We have, additionally, had problems with domestic manufacturers also.

Thus, a dealer cannot escape the intimidation of one manufacturer by going to another. In reality, the manufacturers of the most popular machines realize the control they have, and they take full advantage.

My view—and this is a point I will discuss in greater detail later on—dealers simply do not have the tools to force the manufacturer to negotiate on a truly arms-length, good faith basis. Collective action by NOMDA is of course illegal, and lawsuits under the existing statutes have not been effective in protecting dealers' rights.

I turn to some specific examples. One of the most important issues facing dealers is sales quotas, unilaterally and arbitrarily imposed by manufacturers. Quotas are important in that they give rise to advertising allowances and other sales incentives and are used by manufacturers to determine placement of new dealers and determination or nonrenewal of existing dealers. Manufacturers have had no incentive to provide realistic quotas. From their standpoint, it is far preferable to continue using quotas as swords over dealers' heads rather than as dealers' goals.

Since they are highly useful dealer control tools, manufacturers believe that they can terminate a dealer who does not meet quotas in good conscience, no matter how artificial his quota may have been. I am a Sharp dealer and chairman of the Sharp Advisory Council. In 1980, Sharp had a quota of 83,000 copiers spread among their dealers in the United States. In actual fact, they imported and sold 41,000 units in 1980. The national sales manager got a raise; the vice president got a raise; they all shook hands and had a good day. They were allover quota, and everybody got a bonus except the dealers were less than 50 percent of quota, because the dealers' quota had been set so artificially high.

At one such meeting when I was with the president of Sharp, U.S.A, Mr. Sagawa, I was astonished to hear him congratulate everybody. When I raised the disparity of the in-house quota and that given the dealers', he responded—I said the dealers' quota was too high—he said they would take care of that next year. Well, 1981 quotas are out now, and instead of 83,000 they are down to 82,300.

Normally I'm a more effective negotiator than that, but I will take what I can get.

Moreover, after the president informed me that it was going to be 82,300, I said, "I think you're going to do about 55,000 units." He said, "Never." I said, "I will bet you a dinner at the Four Seasons in New York that you do 55,000 units." And he said, "We will do less, and I will take on that bet."

Now we have the obvious problem of the president of a corporation planning on selling less than 55,000 units but yet managing dealers' territories by having a quota of 82,300. So they are going to be over quota and making money, and my family dealership is going to be threatened.

To reiterate, the reason manufacturers maintain such unreasonable quotas is to keep the dealers in line, to manage the territories by using failure to meet quotas to saturate market areas as an excuse for termination. If I am under quota, they can add more dealers, and the Japanese have shown an extraordinary desire to be mass merchandisers—and that is one of the problems, the proliferation of dealers.

Inequitable placement of new dealers, I just mentioned, is another serious problem. While manufacturers generally do not grant

territorial exclusivity, their pitch to new dealers is replete with verbal assurances not to mess with his markets. As other witnesses will mention, it is important for a dealer to know that his hard work and investment in building a market will be rewarded and that the fruits of his efforts not be stolen.

I was promised an area by a Sharp vice president. He said it would be left alone—I would be left alone to develop my market. Sharp did not hesitate to subsequently appoint a new dealer 15 miles away from me, and I did not object. However, 2 days later the new dealer opened a branch virtually next door to me. In so doing, he was able, without cost, to take advantage of all the heavy advertising for Sharp I had undertaken and all the good will I had generated. I spend $30,000 a month advertising my name and Sharp's, and the reason that I advertise Sharp's name was because I cannot get any reimbursement unless their name is advertised, so I build up the trade name, and now another dealer was appointed to capitalize on that.

One of the things that I wanted to mention, as Senator Exon knows from his experience, it has been said that the reason to be in the copier business is so that you can sell supplies and service, and these are profitable entities in an office equipment dealership. And generally speaking—I have some statistics that I would like to submit for the record.

Generally speaking, the person who buys a copy machine will spend two to three times in excess of the cost of the machine in operating that machine over the life of the machine. Therefore, when you protect your market, not only do you make new sales, but the bigger profits are generated by the continuing relationship of supplies and service. So you have to have the ongoing relationship, and that is one of the keys to protecting the marketplace.

I did a little—I can turn this in later—I did a copy machines, 5,000 copies a month, over a usage of 84 months, which is 7 years, which is a common guarantee period by manufacturers. The machine cost $5,500, and the cost of operating that machine at 5,000 copies a month was $16,309.44 at today's inflation rate. I did not add any Republican single-digit inflation to this, but the fact remains it obviously would be higher over the course of 7 years.

[The chart follows:]

Source	Unit cost	Total monthly cost
Service	$.0195 per copy	$97.50
Paper	$.008 per copy	40.00
Toner	$85 for 10,000 copies	42.50
Developer	$85 for 30,000 copies	14.16
Total monthly cost		194.16
Total cost[1]		16,309.44

[1] Monthly cost times 84 months (average useful life of the machine).

Senator EXON. It is back to double-digit inflation.

Mr. NELSON. I was only thinking about the future.

Hopefully thinking about the future.

Lastly, I was canceled by Savin business machines for failure to reach quota. I spent $10,000 on legal research researching the

antitrust laws to find out that I did not have a case. I also have appeared in other lawsuits as an expert witness for dealers. I appeared in Oregon in a lawsuit a dealer had against Canon. The case resulted in a directed verdict for defendant solely on the grounds that the Oregon statute of fraud barred suit on an oral contract.

That is one of our concerns about this bill, that if we can get a fair and equitable treatment, mutual treatment of each other, that we will be able to litigate the substantive issues rather than get hung up on technicalities. We are looking for a fair and equitable relationship between two parties, and we really do not want to get hung up on the legal matters.

I have represented or currently represent Sharp Electronics Corp., which is Japanese; Mita, which is Japanese; Denison, which is an American company; Southern Business Machines, which is an American company distributing Japanese products; I have been made a dealer for Xerox Corp.—five of the eight greatest leaders in office equipment—and I have found that Xerox has a dealer plan very similar to Sharp's.

I do not know if there has been any collusion, but the problems exist similarly in how the dealer relationships are concerned.

Thank you very much.

[The statement follows:]

STATEMENT OF RICHARD P. NELSON, PRESIDENT, OHIO BUSINESS MACHINES, INC., CLEVELAND, OHIO

Good morning. My name is Richard P. Nelson, and I am president of Ohio Business Machines in Cleveland, Ohio. I am an active member of the National Office Machine Dealers Association, especially in the educational seminars which NOMDA sponsors. I have been an office machine dealer for five years. Prior to starting my own business, I worked for Apeco, a domestic photocopier manufacturer, starting as a salesman and finally leaving as the West Coast general manager. My responsibilities in that position included managing dealers in 13 states. In a sense, then, I can give you perspective from both a dealer and a manufacturer.

Before providing specific examples of the problems jeopardizing our industry, I would like to underscore several points made by previous witnesses. First, the manufacturer's dictatorial power over dealers is a national problem, transcending state boundaries. I have met 3,000 dealers in my NOMDA activities from every state in the Union—the message has always been the same; manufacturers are guilty of the same practices in Ohio, New York, California and so on. In fact, I was not at all surprised to hear that dealers in Canada and England are suffering from the same abuses as we are in this country.

Unfortunately, we are not talking about only one or two manufacturers. Virtually all of the overseas manufacturers are guilty of the same practices. Thus, a dealer cannot escape the intimidation of one manufacturer by going to another. In reality, the manufacturers of the most popular machines realize the control they have over dealers and are taking full advantage.

My view is, and this is a point I will discuss in greater detail later on, dealers simply do not have the tools to force the manufacturer to negotiate on a truly arms length, good faith basis. Collective action by NOMDA is, of course, illegal, and lawsuits under the existing statutes have not been effective in protecting dealers' rights.

I turn now to certain specific examples, which will illustrate just how far removed the manufacturers are from any notion of good faith and fair dealing. One of the most important issues facing dealers are sales quotas unilaterally and arbitrarily imposed by manufacturers. Quotas are important in that they give rise to advertising allowances and other sales incentives, and are used by manufacturers to determine placement of new dealers and the termination or nonrenewal of existing dealers. Manufacturers have had no incentive to provide realistic quotas. From their standpoint, it is far preferable to continue using quotas as swords dangling over dealer's heads rather than as dealer goals, since they are a highly useful dealer

control tool. Manufacturers believe they can terminate a dealer who doesn't meet quotas in good conscience no matter how artificial his quota may have been.

Let me give you some specific horror stories. In 1980, Sharp had a quota of 83,000 copiers for the U.S. market. In actual fact, only 41,000 copiers were exported to the U.S.—less than 50 percent of the quota. This was not a mistake. As a member of the Sharp Dealers Advisory Council, I have the opportunity to meet with Sharp's top management. At one such meeting, I was astonished to hear the president, Mr. Sagawa, congratulate the national sales manager for having "a good year" and being over quota. When I raised the obvious disparity between the in-house quota and that given to dealers, the response was that maybe the dealers' quota was too high, but that would be taken care of next year. Just to show how much good faith Sharp demonstrates, the quota for 1981 was reduced to 82,300 copiers, a far cry from the 83,000 quota in 1980! Moreover, the president informed us that he expects that 55,000 would be the absolute maximum number of copies imported in the U.S. I even bet him a dinner that at least 55,000 machines would be sold in the U.S. Mr. Sagawa accepted my bet, wagering that U.S. dealers would not sell all 55,000—despite total quotas here exceeding 80,000 machines!

To reiterate, the reason manufacturers maintain such unreasonable quotas is to keep the dealers in line, to manage the territories by using failure to meet quotas, to saturate market areas and as an excuse for termination.

The inequitable placement of new dealers I just mentioned is another serious problem. While manufacturers generally do not grant territorial exclusivity, their pitch to new dealers is replete with verbal assurances not to mess with his markets. As other witnesses will mention, it is important for a dealer to know that his hard work and investment in building a market will be rewarded and that the fruits of his efforts not be stolen. When I started in business as a dealer, I was promised by a Sharp Vice President that I would be left alone to develop my market. Sharp did not hesitate subsequently to appoint a new dealer 15 miles from me, and I did not object. However, two days later, that new dealer opened a branch virtually next door to me. In so doing, he was able, without cost, to take advantage of all the heavy advertising for Sharp I had undertaken and all the goodwill I had generated.

Who is the loser when manufacturers saturate a market with dealers? Certainly not the manufacturer. It is the dealers and the consumers who are hurt because dealers must cut profit margins to unreasonable levels and even scale back service. As you know, the key to any office machine is service and supplies, which, over the life of the machine, cost more than the initial price. So, in the end, it is the consumer who suffers. Manufacturers seem to consider service unimportant because it is the dealer's responsibility.

Yet, when the manufacturer has wholly-owned sales branches which compete with independent dealers, they sing a different tune. I recently testified as an expert witness in a trial in Oregon state court in a suit brought by a prospective dealer against Canon. The prospective dealer had decided to take on the Canon line, been given an oral contract, and sent his employees to Canon's service school. However, when Canon discovered that the dealer had a branch in Los Angeles which could compete with Canon's wholly-owned sales branch, he was cancelled.

Another example of how manufacturers bend the rules they themselves have established is the implicit sanction they give to unauthorized dealers, dealers who do not have even an oral dealership agreement. In Los Angeles county, there is one authorized dealer, and there are at least fifteen unauthorized Sharp dealers. Unauthorized dealers purchase the machines in other parts of the country and do not have service capability. The authorized Sharp dealer quite naturally refused to service the machines he did not sell. He was concerned about his capabilities to service his own customers. Yet, Sharp ordered him to service even the unauthorized machines, all at his own expense, or face immediate competition through a wholly-owned branch operation.

The final point I wish to make is to reiterate that current laws simply do not afford office machine dealers a reasonable remedy to the unfair and inequitable treatment we continually receive. The antitrust laws as they have been historically interpreted, and even basic contract law are of no help. In the several situations I have considered suing a manufacturer, my attorney has advised me that such action would be futile. In fact, after my cancellation by Savin, which I will discuss in a minute, I spent over $10,000 on legal research only to be told that I didn't have a case. The Oregon lawsuit against Canon I previously mentioned is another good example. That case resulted in a directed verdict for defendant solely on the grounds that the Oregon Statute of Frauds barred suit on an oral contract. The judge refused reluctantly to let the case go to the jury and in open court criticized the defendant for undertaking such inequitable actions. The case was tried only on

the contract issues because the plaintiff's lawyers informed him that antitrust grounds were simply not available.

The case of my termination by Savin is another useful example. I was terminated for failure to meet sales quotas, even though the largest impediment to improving Savin sales was Savin itself. I was Savin's service agent for their government sales, which they handled directly, and was therefore obligated to spend large sums for parts and other servicing requirements for which partial reimbursement was due from Savin. Even though they owed me thousands of dollars due to their consistent 3 to 12 month arrearages in payment, they would not even continue to provide parts to meet service obligations for existing customers, causing me further expense and hardship. Needless to say, Savin has still refused to buy back my inventory or offer any compensation for the goodwill I have generated. It is interesting to note that very soon after my termination, Savin established a wholly-owned branch operation in my area.

I would be happy to answer any questions that you may have.

QUESTIONS OF SENATOR EXON AND THE ANSWERS THERETO

Question 1. In your opinion, why do manufacturers behave as they do? Don't they realize how essential servicing is to a successful sales program?

Answer. This question drives at the very heart of the problems office machine dealers are having today and the basic rationale for S. 1256. It is quite clear that the large manufacturers behave as they do because their superior economic bargaining power in the office machine industry has removed any possible mitigating forces, either strong domestic competition or large, highly-capitalized dealers. The economic realities are such that these manufacturers do not have to treat their dealers fairly and equitably and consequently do not do so.

From a different perspective, the big manufacturers have as their highest marketing priority maximizing sales, not maintaining service, "moving boxes" not seeking customer satisfaction. Since all servicing and contact with the consumer are handled by the dealer, who must carry all product warranties, the manufacturer knows it will be shielded from product reliability and similar service problems. Manufacturers have learned that service-related costs can be passed on to their dealers, who will usually choose not to assess their customers similarly out of concern for their long-term business potential. Consequently, already-thin dealer profit margins are significantly eroded, while the end-user's servicing costs are kept at the same level.

Question 2. Don't consumers benefit when there is a fierce competition between dealers in the same market?

Answer. To answer this question, we must focus on the distinction between two types of competition: interbrand competition—that between dealers representing different manufacturers—and intrabrand competition—that between dealers representing the same manufacturer. In our industry, interbrand competition is by far the most important factor. For instance, the fact that there are 31 different manufacturers of copiers gives a dealer the strongest possible incentive to keep prices low.

Given this situation, the benefits of interbrand competition are far less evident. The over-saturation of a market with more dealers than economic conditions warrant ultimately hurts the consumer. In that situation, great, often insurmountable, financial strain is imposed on the dealer, who is discouraged and often prevented from committing resources to promotion, advertising and, most importantly, customer service. Such pernicious interbrand competition often results in financial insecure dealers who are much more likely to go out of business leaving consumers with machines but without crucial supplies or satisfactory servicing capabilities.

Senator PRESSLER. Thank you.

I will now call on my fellow South Dakotan, Merlin Jeitz, president of Cook's, Inc., in Watertown, S. Dak. He has been active in the National Office Machine Dealers Association and can speak directly to the problems facing office machine dealers in small communities and rural areas.

I am proud that we also have Loren Steele, who is executive vice president of Super 8 Motels from Aberdeen. I am told the Super 8's were originally started in South Dakota. A lot of great things happen in South Dakota thanks to our small businessmen.

I gave a speech to the Anti-Defamation League, and I talked about discrimination by intellectual people. In my brief student days at Oxford and Harvard, whenever I said I was from South Dakota I would always get some kind of a remark, kind of a discriminatory remark from people who had never been there. They don't know what a great State we have.

We have about 2 million tourists which visit our State every year, which is almost four times as many people as we have living there, which indicates the attractions that we have.

One of our outstanding businessmen is Merlin who is from a town that I go to frequently. We really appreciate your being here.

STATEMENT OF MERLIN JEITZ, PRESIDENT, COOK'S, INC., WATERTOWN, S. DAK.

Mr. JEITZ. Thank you, Mr. Chairman.

I am the president of Cook's, as you indicated. I founded the company 22 years ago. My company carries a full line of office equipment. That includes supplies, furniture, and machines. Included in the machines, we carry cash registers, copiers, typewriters, and most of the things other dealers carry. I have been a dealer for many manufacturers and particularly Olivetti since 1959, Sharp since about 1969, Saxon Copiers, Delta Cash Registers, and so on.

We have a total of 18 service and sales people, a total of 45 people.

As a previous witness has pointed out, the fundamental and currently unsurmountable difficulties facing office machine dealers throughout the country is the stranglehold manufacturers have over dealers. I would like to speak for a few minutes about several specific examples of the manufacturers "'damn you all" to the dealer, attitude which their economic power permits them.

I personally, along with dealers all over the country and these gentlemen at this table, have suffered from such abuses as arbitrary establishment of sales quotas, manufacturer misrepresentations regarding the terms of my dealer agreement, as well as product reliability or unrealiability, coercive practices, suppliers adopted for selling new products and in establishing new dealers.

The sales quota system that has been mentioned this morning is established by manufacturers, and it appears to have no relationship whatsoever to the actual size and potential of my market area. When I am given a quota that compels me to sell many times more equipment percentagewise than my market could ever absorb, it is clear to me that these quotas are not made with me in mind, and they are made far away from South Dakota, many times perhaps in a corporate office in Tokyo.

A quota system, created and imposed unilaterally on dealers by the manufacturers, gives the manufacturer great latitude in terminating dealers. It is also an easy way to avoid responsibility for paying dealer performance and advertising allowances that had been promised if you meet quotas. This often happens when manufacturers establish quotas, knowing that they do not intend to produce or import enough machines to fill all of the orders that every dealer has. The dealer, of course, has no recourse to make

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the manufacturer uphold his end of the agreement, and this is widespread.

Another problem facing dealers in my part of the country is financing. Bankers are frankly hesitant to lend money for new products or other invoices for a product when he sees many thousands of dollars of worthless inventory sitting in a warehouse. These are products that are there because of misrepresentations about the products' capabilities or the gross defects which appear only when the goods have been placed in my customers' offices.

It is natural to ask why a dealer would take machines without seeing them being tested. The reason can be found in the manufacturers' coercive selling practices.

Last year Sharp introduced a new copier which it claimed to be the state of the art. Dealers were told that the copier was in production and production testing in Japan, but if orders were not placed immediately, there would be delivery problems in the future.

My dilemma is this—allowing my competitors to begin selling a new model and risk not getting a supply of my own or waiting to see if the machine has problems. In our competitive industry, you just cannot afford to wait.

The message is clear. Intent on pushing new products as rapidly as possible, manufacturers avoid responsibility for defective products simply by imposing all after-sales service requirements on the dealers, including the necessity to install retrofits, which were described earlier, and I would like to clarify that—the statement made by John.

He indicated a retrofit is to make machines run better. I would qualify that and say that a retrofit is to make a machine run like it was originally intended to run. Anyway, we must install these retrofit kits at our expense, and these should have been remedied at the factory when they were made. We should not have to have those.

Under current conditions, coercion of servicing is widespread. There is a dealer in Rapids City whose major customer is an Air Force base. Savin, without warning, began selling directly to the base, thereby undercutting its own dealer. Not only did the dealer lose sales, but Savin told him to assume all of the service responsibilities with all these consequences—consequences for his costs, incidentally. When the dealer naturally objected, he was told that he would be terminated for his failure to do as the manufacturer wished.

Inequitable practices involving the establishment of new dealers and termination of existing dealers have affected me as well. Let me give you a personal example.

Sharp named a dealer in Mitchell, S. Dak., which is 125 miles from me—clearly out of my market area. Yet with Sharp's knowledge, they allowed the Mitchell dealer to establish branch offices squarely within my backyard, and thereby at no cost reaping the benefits of the good will and advertising I had generated for Sharp on my own behalf. I was not told why this warranted, and my quota remains just as high but with less territory.

I was a dealer for Saxon and bought 15 units. Unfortunately, none performed consistently, even with an additional $60,000 in

retrofits and service costs. When I refused to purchase Saxon's new model that came out after that, I was terminated, with no compensation for my previous inventory or expense.

Incidentally, these machines were given to a dealer in Madison, Wis., who used them for parts.

Mr. Chairman, I can say, unequivocally, that were the Retail Dealers' Act law, I would not hesitate to use it to seek redress from the grossly unfair practices of companies such as I have described, which intimidates dealers and subjects them to financial hardship and abuse. Clearly, a good faith standard would set some very broad guidelines without unnecessarily interfering in dealer-supplier contracts.

I urge the passage of S. 1256 and ask that this be entered for the record.

[The statement follows:]

STATEMENT OF MERLIN JEITZ, PRESIDENT, COOK'S, INC., WATERTOWN, S. DAK.

Good morning. My name is Merlin Jeitz. I am president and owner of Cook's, Inc., in Watertown, South Dakota, which I founded 22 years ago. My company carries a full line of office equipment: from furniture and office supplies to office machines, including electronic cash registers, copiers and typewriters. I have been a dealer for Olivetti since 1959 and for Sharp since 1969, and, in the past, for Saxon copiers and Delta cash registers. I am an average size office machine dealer, with 18 sales and service personnel.

Although I am not an officer of NOMDA, I am active in that organization and have had the opportunity to meet many other members and discuss the problems facing our industry. As the previous witnesses have pointed out, the fundamental and currently insurmountable difficulty facing office machine dealers throughout the country is the stranglehold manufacturers have over the dealers. Because of the overwhelming advantage they have in economic bargaining power, built up over a number of years, they can force dealers to play by their rules or not be in the game at all.

I would like to speak for a few minutes about several specific examples of the manufacturer's "Dealer be Damned" attitude which their economic power permits them to adopt. I personally, along with dealers all over the country, have suffered from such abuses as: arbitrary establishment of sales quotas; manufacturer misrepresentations regarding the terms of my dealer agreement as well as product reliability; coercive practices suppliers adopt in selling new products and in establishing new dealers.

The sales quota system established by manufacturers appears to have no relationship whatsoever to the actual size and potential of my market area. No one has ever given me an explanation of how the quotas are established in the first place. Frankly, the entire system seems irrational. When I am given a quota which compels me to sell a thousand times more equipment percentage-wise than my market could ever absorb, it is clear to me that decisions affecting my very livelihood are being made far away from South Dakota and often overseas in corporate headquarters in Tokyo. I have made suggestions that our quotas be determined according to county purchasing power derived from national statistics compiled by the Business Equipment Manufacturers Association. However, apparently my ideas have fallen on deaf ears.

A quota system created and imposed unilaterally on dealers by a manufacturer gives that manufacturer great latitude in terminating dealers. It's also an easy way to avoid responsibility for paying dealers allowances it may have promised for meeting given quotas. Another variation of quota abuse occurs when manufacturers establish quotas knowing that they don't intend to produce or import enough machines to fill all the orders were every dealer to meet his assigned quota. Some manufacturers offer a QPA or Quarterly Performance Allowance, which is an incentive to dealers to sell more by giving them a certain percentage of the sales exceeding a set figure. In addition, advertising allowances are given dealers only if they can meet their quotas. Thus, when a dealer can't possibly meet a quota or when the manufacturer cannot ship enough equipment to meet dealer orders promptly, then they avoid the QPA and the obligation to pay for advertising

allowances, which together can mean as much as an eight percent discount to the dealer.

Another problem facing dealers in my part of the country is that manufacturers often do not offer written contracts, or if they do, many important elements are oral, all, of course, on a take it or leave it basis. Even if there is a written contract, it is of no real assistance to the dealer in one very important area: financing. Most dealers have to borrow money to pay for their inventory. Yet, what banker is going to lend me $20,000 for new products when he sees an equal amount of already inventoried products in my warehouse which are worthless because of my supplier's misrepresentations about the product's capabilities or gross defects which appear only when the goods have been placed with my customers in the field?

It is natural to ask why a dealer would take machines without seeing or testing them. The reason can be found in the manufacturer's coercive selling practices. For instance, in July 1980, at NOMDA's Annual Convention, Sharp introduced a new copier, which it claimed to be the state of the art. They did not have actual models with them; however, dealers were told the copier was in production and was being tested in Japan. Furthermore, they stated that if orders were not placed immediately, there would be delivery problems in the future. The implication was clear: should I order machines, running the risk that, as in the past, the machines have in fact not been fully tested and have problems, or should I let my competitors buy it and not have the machine later on? Almost every dealer will opt to buy the machines, and the manufacturer knows it.

Another abuse, frequently practiced by Olivetti, is that their sales reps will offer a new machine to me sight unseen, "guarantee" that it is a good product and "promise" that if I buy a substantial number, he will "try his best" to move it to other dealers if it does not meet my expectations. Yet, when problems do develop, all these guarantees and promises are forgotten.

Both of the above examples illustrate that manufacturers are treating the U.S. market as nothing more than a field-testing ground. Intent on pushing out new products as rapidly as possible, manufacturers avoid responsibility for defective products simply by imposing all after-sales service requirements on dealers. Manufacturers do not have warranty obligations to end-users and do not hesitate to force dealers, at their own expense, to install retrofit kits to remedy defects which could have been solved in Japan. Often, a "new" model is nothing more than the previous model with the bugs worked out.

It is bad enough that responsibility for service rests solely on the dealer with the manufacturer's profits insulated from frequent warranty claims and servicing requirements. However, the problem is often worse. There is a Savin dealer in Rapid City, whose major customer was an Air Force base. Savin, without warning, began selling directly to the base, thereby undercutting its own dealer. Not only did the dealer lose sales, but Savin told him to assume all service responsibility with obvious consequences for his costs. When the dealer naturally objected, he was told that he would be terminated for his failure to do as the manufacturer wished.

Inequitable practices involving the establishment of new dealers and termination of existing dealers have affected me as well. The efforts and investment of dealers in building a market area are irrelevant to manufacturers who are merely interested in moving products. Failure to meet unreasonable quotas is always an available excuse to place a new dealer in a market area successfully built by an existing dealer. Other practices are more subtle, yet equally inequitable. Let me give you a personal example. Sharp named a new dealer in Mitchell, South Dakota, which is 125 miles from me, clearly not within my market area. Yet, with Sharp's knowledge, the Mitchell dealer established branch offices squarely within my backyard, thereby, at no cost, reaping the benefit of the goodwill and advertising I had generated on Sharp's behalf. Of course, I was not consulted nor even given the opportunity to discuss with Sharp why such an action was warranted. Yet, my quota remains just as high, and I am deprived of the QPAs and advertising allowances, which are crucial to my continued profitability.

The termination problem mentioned by other witnesses has affected me as well. A few years ago, I was a dealer of Saxon copiers and initially bought 15 units. Unfortunately, none worked even reasonably well. I paid $4,000 per unit and then was forced to spend another $4,000 per unit on retrofits and other repairs, which still did not make the copiers functional. In the end, I could not sell even one of Saxon's copiers. Saxon wanted me to purchase its new model. When I refused to do so without receiving some financial redress for this previous fiasco, I was terminated with no compensation for my previous inventory or expense.

Mr. Chairman, I can say unequivocably that were the Retail Dealers Agreement Act law today, I would not hesitate to use it to seek redress from the grossly unfair practices of companies such as I have described today, which seek to intimidate

their dealers and subject them to financial hardship and abuse. Clearly, a good faith standard would set some very broad guidelines without unnecessarily interfering in dealer-supplier contracts. More importantly, I firmly believe that it would be an impediment to these manufacturers' continuation of previously documented abuses, allowing dealers like myself from having to worry about legal remedies to keep my small business afloat. I should rightfully be concerned only about sales, service and customer satisfaction. You can make that possible through passage of S. 1256.

QUESTIONS OF SENATOR EXON AND THE ANSWERS THERETO

Question 1. How can S. 1256 help you meet unreasonable quotas?

Answer. I believe that S. 1256 will clearly and unequivocably eliminate "unreasonable quotas" as a common practice by office machinery manufacturers. Consequently, I would not be responsible for meeting any such quotas and would not be subjected to the threat of cancellation or non-renewal which usually occurs in such situations.

Section 3 of the bill, which requires manufacturers to treat their dealers in a fair and equitable manner, gives such manufacturers an incentive to establish realistic and mutually agreeable (between manufacturer and dealer) sales quotas. Moreover, these quotas will be viewed by both parties as attainable goals, with benefits to both sides. No longer will a manufacturer be able to set unreasonable, arbitrary quotas or standards of performance for the purpose of coercing or intimidating its dealers. Fairness will become the standard.

Question 2. When you complain to a manufacturer about their practices, what is the response?

Answer. The responses I have most often heard are as follows: "Well, you're the only dealer of that product who has reported problems with it, so I'm not certain that the difficulty lies with the product", or "No other dealer has registered any complaint with us regarding (a particular marketing practice)". The point here is that manufacturers often refuse to concede the existence of problems even though their dealers throughout the country constantly complain of them individually and collectively through NOMDA.

Sometimes, a manufacturer will offer to investigate a complaint or to remedy a problem, without any real intention of doing so. Often, a commitment will be made by a National Sales Manager or an executive of similar rank; yet, six months later, no action has been taken. In addition, if I ever complain too adamantly, I am reminded of other dealers in the area who would love to represent the manufacturer.

In sum, as long as manufacturers can refuse to admit to problems or fail to resolve them, despite their repeated disingenuous promises to do so, their dealers will have to pay the price, and their customers will suffer.

Senator PRESSLER. Thank you very much for that excellent testimony.

Those places you mentioned are right near my howntown, and our hardware dealer there in Humbolt has told me he has had similar problems.

Next, I will call on Nat Israel for his testimony. Mr. Israel is president of CTR Business Systems, Inc., from Portland, Oreg.

STATEMENT OF NAT ISRAEL, PRESIDENT, CTR BUSINESS SYSTEMS, INC., PORTLAND, OREG., APPEARING ON BEHALF OF THE NATIONAL OFFICE MACHINE DEALERS ASSOCIATION

Mr. ISRAEL. Good morning.

My name is Nat Israel. I am president of CTR Business Systems in Portland. I am also a member of the National Office Machine Dealers Association, on whose behalf I am appearing today.

Being the last witness to testify and knowing the fact that everybody would be glad if we could save a little bit of time, I have summarized and gotten what I have to say down to 5 minutes.

I would request that my full statement be submitted for the record.

Senator PRESSLER. Without objection, it is so ordered.

Let me say if there are other things that any other witnesses have subsequently that they want to submit, we will consider that.

We appreciate your summarizing.

Mr. ISRAEL. Thank you.

I am the owner-operator of my dealership in Portland, Oreg., which my father established as a typewriter company in 1913. We are one of the oldest dealers on the west coast. I joined my dad in 1939. My wife came along a few years later, and my son is now pursuing his career with the company. We are a family-oriented company for almost 70 years.

CTR Business Systems is average in size, employing about 20 people, sales, service, and administrative. We carry three main product lines, dictating equipment, typewriters, and word processors. We represent both foreign amd domestic manufacturers, mainly Norelco, Olivetti, and Lexitron.

I would like to reiterate what the witnesses have said today about manufacturer treatment of dealers. A main concern of mine for a long time has been the blatant lack of good faith which many manufacturers have exhibited in their dealings with office machine dealers. These are the very people who are responsible for their profitability and growth.

I would like to take the committee's time to describe for a minute a specific example which illustrates this concern. It involves some very recent problems I have had with Norelco, a Dutch manufacturer of dictating machines. My company was one of the earliest dealers for Norelco on the west coast, and probably in the country. We established a relationship with them more than 20 years ago. And since then I have invested my time and money to promote the Norelco name through advertising and personal selling.

All in all, had it not been for my efforts on Norelco's behalf over the past two decades, Norelco would not have had the market share in Oregon which it does today.

In addition to my dealership representing Norelco products, I have, until recently, operated an exclusive distributorship for them in the State of Oregon. Over a period of time, I established a very successful network of 18 to 20 subdealers who, like myself, were willing to spend their time and money to develop the Norelco name in Oregon.

These dealers relied on me, not just for the product, but for parts, schematics, reference manuals, retrofit kits, sales materials, and all of the other ingredients necessary to operate a successful office machine dealership. I guaranteed them good service, responsiveness, and flexibility. In other words, I was willing to "go the extra mile" on Norelco's behalf.

And what did I get in return for these efforts? In June of this year, Norelco, with very little advance warning, announced that from that time on all of its distributors would be effectively eliminated. This was accomplished by allowing its dealers to purchase their products directly from the manufacturer's distribution facilities, at the same price the distributors were paying. This action was taken not just in Oregon but in every State in the Union. The impact has been considerable.

First, I have lost some customers, including my biggest dealer, which would not have happened in the absence of Norelco's actions.

More importantly, my projections for future growth and the purchasing decisions I have made based on those projections have been rendered useless. I have lost whatever profit margin I had in order to move what is now excess inventory.

Frankly, the greatest impact on me and my business lies in the future. What might have been an achievement 20 years in the making has become just another illustration of how a manufacturer like Norelco intends to repay my good faith in developing a market for them. It is just another example of the inability of a dealer today to create, nurture, and protect the assets which results from his success in business.

Before I close, I would like to mention one other example of our frustrations. This case is Olivetti's decision to sell its electronic typewriter through the new Sears business systems centers. The situation is indicative of the fact that a manufacturer's primary objective is to keep on boosting orders and sales which derive from dealers or other retail outlets. After-sales service, and end-user satisfaction, is not management's most major concern. Indeed, Olivetti's dealer advisory council, was not even forewarned of the Sears marketing agreement.

In response to complaints that existing dealers were not informed that the agreement had been signed—they weren't told until 4 days after the Wall Street Journal reported it—and what did Olivetti's director of communications say? "It was a mistake that our dealers did not know beforehand." That was quite an observation on his part.

The facts are that the Sears deal is possible only because hundreds of Olivetti dealers across the United States had made substantial investment of capital, management time, and other resources in developing demand for the electronic typewriter and building a reputation for the name "Olivetti." Yet, Olivetti not only chooses to destroy this asset of enormous value, but does so without so much as a hint to the people who made it all possible.

Both the Norelco and Olivetti examples illustrate then an urgent need for legislation along the lines of S. 1256. Not only would a standard of good faith clarify the now murky nature of manufacturer-dealer relationships in our industry, but suppliers would henceforth be cognizant of the substantial contributions dealers make to develop goodwill toward their products.

We must be allowed to reap the benefits of our efforts. Otherwise, it may well behoove us to move on to another line of business.

Thank you very much, Mr. Chairman, for the opportunity of giving us an opportunity to air our concerns before the subcommittee today.

I will be happy to answer any questions you may have.

[The statement follows:]

STATEMENT OF NAT ISRAEL, PRESIDENT, CTR BUSINESS SYSTEMS, INC., PORTLAND, OREG.

Good morning. My name is Nat Israel. I am president of CTR Business Systems, Inc., in Portland Oregon. I am also a member of the National Office Machine Dealers Association, on whose behalf I am appearing today.

I am the owner and operator of my dealership in Portland, which my father established as a typewriter company in 1913, and we are probably one of the oldest dealers on the West Coast. My wife and I followed in my father's footsteps in 1939, and my son is now pursuing his career with my company. I hope that he has the opportunity as well as the incentive to carry on when I am long gone. After 70 years, it's a family tradition, to say the least.

CTR Business Systems is average in size, employing about twenty people, sales, service and administrative. We carry three main product lines: dictating equipment, typewriters and word processors. We represent both foreign and domestic manufacturers.

When NOMDA first began its effort some years ago to negotiate with the manufacturers of office machines for fairer and more equitable treatment of their dealers, I gave it my full support. In fact, I figured the campaign would be short-term anyway because these manufacturers were certain to know that such treatment was in their own long-term best interests and would not impede their flexibility from a marketing perspective. A growing awareness of the real perspective of manufactures in this industry, together with some recent shock treatment, has made me realize that our suppliers aim to maintain or increase their share of the economic pie even if it comes at their own dealers' expense.

A major concern of mine is the blatant lack of good faith which many manufacturers have exhibited in their dealings with office machines dealers, the very people who are responsible for their profitability and growth. I would like to take the Committee's time to describe for a munute a specific which illustrates this concern. It involves some very recent problems I have had with Norelco, a Dutch manufacturer of dictating machines.

My company was one of the earliest dealers for Norelco on the West Coast, having established a relationship with this manufacturer more than twenty years ago. Since that time I have promoted the Norelco name through advertising and personal selling as representative of quality and service. I have spent enormous sums to make sure that my salesmen were trained in the lastest marketing techniques and that my service personnel were schooled in the most recent technological advances in dictation equipment manufacture and maintenance.

Whatever suggestions or recommendations Norelco has made to me to help boost sales have been received in a spirit of utmost cooperation and a willingness to proceed together. All in all, had it not been for my efforts on Norelco's behalf over the past two decades, Norelco would not have had the market share in Oregon which it does today.

In addition to my dealership representing Norelco products, I have until recently operated a distributorship for Norelco in Oregon. Out of some 70 distributorships across the country, none of which was owned by Norelco directly, Norelco contracted with me to handle Oregon as an exclusive sales territory. Over a period of time I established a very successful network of some 18–20 dealers who, like myself, were willing to spend their time and money to develop the Norelco name in Oregon.

These dealers relied on me not just for products, but for parts, schematics, reference manuals, retrofit kits, sales materials and the many, many other ingredients necessary to operate a successful office machine dealership. I guaranteed them good service, responsiveness and flexibility. In other words, I was willing to "go the extra mile" on Norelco's behalf.

For Norelco, I maintained an inventory of products and spare parts, which were purchased with regular financing at the usual distributor discount from the suggested retail list price. I then sold these products and parts to my dealers at a small markup to cover inventory financing and other costs as well as a very thin margin of profit. I have never required the dealers to purchase a minimum of machines, as do many manufacturers today. My primary concern was meeting dealer and therefore consumer and end-user needs, not just "moving boxes".

Unfortunately, I must end what could have been a wonderful success story with a description of what Norelco, at the stroke of a pen, did this year to ruin my distributor business. Norelco, with very little advanced warning, announced that from now on, all its distributors would be effectively eliminated. This was accomplished by allowing its dealers to purchase their products directly from the manufacturer's distribution facilities, at the same price the distributors were paying. This action was taken not just in Oregon but in virtually every state in the Union.

The impact has been considerable. First, I have lost some customers, including my biggest, which would not have happened in the absence of Norelco's actions. More importantly, my projections for future growth and the purchasing decisions I have made based on those projections have been rendered useless. While my efforts to maintain short delivery times and my willingness to accept purchase orders with no minimum requirement may allow me to keep some dealer customers, I have lost

whatever profit margin I had in order to move what is now excess inventory. Furthermore, I wouldn't be surprised if eventually all of my dealer customers left me. I can see real concern on their part that adverse consequences may befall them if they do not buy directly from Norelco. What precluded my suffering the fate of others in my position was that I was able to maintain a number of my end-user customers. Unfortunately, I personally know of two dealers in Texas and New York whose customers have left them in droves and who are consequently in serious danger of going out of business. Needless to say, Norelco has refused to repurchase the inventory from their former distributors or to afford any compensation for the goodwill they generated on Norelco's behalf.

Frankly, the greatest impact on me and my business lies in the future. What might have been an achievement twenty years in the making has become just another illustration of how a manufacturer like Norelco intends to repay my good faith in developing a market for it with such unfair and inequitable treatment. It is an act of which the real impact will probably weigh most heavily on my son, if he continues to follow in my footsteps. The future returns as a result of my past efforts were expected to be more than adequate, but they are clearly now in jeopardy. In sum, I believe this example speaks to the real danger facing the dealer in today's office machine industry—i.e. the inability to create, nurture and protect the asset which results from a dealer's success in business.

Before I close, I would like to mention one other illustration which will help explain the frustration office machine dealers develop in creating an asset—for example, a market for a new product or company—for which they receive little real return. This case is Olivetti's decision to sell its electronic typewriter (Models ET 121, 221 and 231) through the new Sears Business Systems Centers.

The situation is indicative of the fact that a manufacturer's primary objective is to keep on boosting orders and sales, which derive from dealers or other retail outlets. After-sales service and end-user satisfaction is not management's most major concern. Indeed, Olivetti's Dealer Advisory Council was not forewarned of the Sears marketing agreement. In response to complaints that existing dealers were not even informed that the agreement had been signed until four days after the Wall Street Journal reported it, Olivetti's Director of Communications could only say, "It was a mistake that our dealers didn't know beforehand".

The facts are that the Sears deal is possible only because hundreds of Olivetti dealers across the United States made substantial investments of capital, management time and other resources into developing demand for the electronic typewriter and building a reputation for the name Olivetti. Our compensation was to have been increased sales and profits as this market became fully developed. Yet, Olivetti not only chooses to destroy this asset of enormous value but does so without so much as a hint to the people who made it all possible. I think such a move may jeopardize Olivetti's dealer network nationwide and even the goodwill generated for Olivetti products. While only five Sears outlets are being opened this fall on an experimental basis, Olivetti's disregard for and high-handed treatment of its dealers is considerable cause for concern, in my opinion.

Both the Norelco and Olivetti examples illustrate, then, an urgent need for legislation along the lines of S. 1256. Not only would a standard of good faith clarify the now murky nature of manufacturer-dealer relationships in our industry, but suppliers would, henceforth, be cognizant of the substantial contributions dealers make to develop goodwill toward their products. We must be allowed to reap the benefits of our efforts. Otherwise, it may well behoove us to move on to another line of business.

I wish to thank Senator Pressler for giving us an opportunity to air our concerns before the Subcommittee today, and will be happy to answer any questions you may have.

QUESTION OF SENATOR EXON AND THE ANSWERS THERETO

Question 1. Did you have any agreement with Norelco that if termination of your distributorship did occur they would buy back your inventory?

Answer. Norelco refused to place in our agreement any provision for their repurchase of my inventory upon termination. Furthermore, they specifically reserved the right to terminate me "for any cause", and immediately upon termination, I would be prohibited from using their name in any way or displaying any of their products, giving Norelco unfettered rights to the market I developed in their name.

Senator PRESSLER. Thank you very much.

I am going to ask a couple of questions, and then I'm going to turn it over to Senator Exon.

First of all, Merlin, in South Dakota we have a lot of small towns. Watertown is one of the biggest towns. But on a national scale it would be considered a small town.

I keep hearing similar complaints. And I'm wondering if this carries over in the appliance business? For example, some small-town dealers who provide after the sale service say they suffer from competition with large chains of discount stores. They put ads on TV that you can buy the appliances very cheaply, below what the local dealer can sell them for, and everybody goes to Sioux Falls and buys the appliance or the TV from the discount store. But then there is no service provided, and the service falls back on the local dealer, who has not been able to make the basic sale. And yet he has to service the product. Is that related to your problem?

Mr. JEITZ. We all have similar problems. I think the latest testimony, that Mr. Israel gave, is the indication of what will happen with the Olivetti electronic typewriter.

As you recall, if I may elaborate a moment, we started with Olivetti in 1959. We were their dealer for South Dakota and for part of North Dakota. Gradually, they kept putting more dealers in our territory, again without our knowing about it. We finally have it down now to Watertown.

Now, these products—and I can indicate many people—Smith-Corona has been notorious for this for years. Any one of you could buy typewriters, take them to your local dealer, and he was to service them. One time Smith-Corona attempted to repay us for that, but that was $5 a time. And I'm sure you can agree that that is not very equitable. But we must do that.

Sharp and many other manufacturers have a lot of consumer goods that are widespread in the industry. And the only way that a customer can get service on them is either to send them back or take them to their "Sharp dealer." In our area, Cook's is the Sharp dealer and everybody knows it; so consequently, they bring all of this "junk" in and we have to service it or we have unhappy customers.

I would guess our plight then, to answer your question, is similar to that which you indicated with the appliance dealers, the same thing.

Senator PRESSLER. What do you say when someone calls you up and says, "Look, I have this brand of appliance or typewriter, or whatever. It has broken down." You have not heard of it or sold it. What is your response? I'm sure you want to help them.

They probably feel that you are irresponsible if you don't provide service in a small town. You want to help them; don't you?

Mr. JEITZ. Being the sales organization we are, we have to say, "Bring it in. We will take a look at it, and we will give you an estimate before we do the repair."

That is the only recourse we have, because we cannot tell them, on the phone, "Get lost." With a town of 15,000 people, you would not be in business very long. We must bring them in. We attempt to fix them.

As repair costs are in the area of $40 to $50 an hour, the total cost, the parts, the time you stop from doing productive work and

get over just to give an estimate, you are losing money by them bringing them in the door. But we do not turn them away, not without at least letting them know that we would look at it.

Senator PRESSLER. Maybe this is unfair, but I suppose if you were in New York City there would be enough dealers that you could say, "We service only our brand, or only the ones we have sold," and then the person could go to another source. You are the doctor in Watertown, so to speak.

Mr. JEITZ. More than that, we advertise. We spend an awful lot of money for advertising our name. And when that product bears the name of a product we sell, it would be silly for us to advertise Sharp on television, on radio, in newspapers. And then when they have a Sharp product, they can't take it to their "Sharp dealer" and get the repair. Consequently, we get a bad name out of that, with no compensation for it.

Senator PRESSLER. On the other hand, if your repair business is profitable, that would be to your advantage. But maybe your repair business is not so profitable.

Mr. JEITZ. I would like to explain a little bit about repair. In order for us to take a new product on, any lines that any of us have mentioned, when a new product exists—and my testimony indicated some of those—the first thing we do, we pack our servicemen on an airplane, ship them to the factory for training. Every product we sell we are factory-trained on. Our people come back and cross-train other people in our department. We have 10 servicemen.

Now, we cannot train on everything. Therefore, when they bring products in that we have no training on, it is almost impossible for us to do a good job of servicing it. It is an expense that we cannot afford on all products, so we cannot possibly service them all.

Senator PRESSLER. Many of our small-town businessmen sell products of name brands; don't they? Providing service is even more significant in a smaller city—Watertown is a very small one—where you are the community representative. You just cannot let people down.

That is repeated all over the United States. I am sure it is probably repeated in New York City, too. I don't want to imply that dealers in New York City wouldn't have the problem, but I think people would have more options. You are the only option in Watertown in terms of repair, as a practical matter.

Mr. JEITZ. Most dealers are in towns of our size, and they have the same problems, even much larger than that. It is one of the other things I don't think any testimony was given regarding that that faces every one of us.

Senator PRESSLER. I have to step out of the hearing to meet with some Cheyenne River tribe people who are here from my State. I have many more questions, but I want to turn it over to Senator Exon for his questions.

I will return in just a few minutes.

Senator EXON [presiding]. I can't tell you how much I appreciate the fact that you have come here this morning. I recognize it has not been an easy thing for you to do. Many of the names that you have mentioned this morning are very, very familiar to me.

I suspect that you are here this morning not because you enjoy it—because there's always the risk that you are running of having the manufacturer say you are the one that went into Washington, D.C., and gave testimony against our company. If you're like I was when I was a dealer, the quotas were set so high that if you—if any of you ever meet your quotas, I would suggest that you were dealing with a manufacturer who did not know how his competitors set quotas. Therefore, they always have you on the defensive.

I suspect basically, gentlemen, you are here today because you really have no other option, as we look to the future, unless we can do something to bring about some degree of fairness.

Now, when we talk about degree of fairness, I want to get into the record the fact that in introducing this bill, I must say that I think it is not a panacea. It is not going to solve all of the problems. What this bill is intended to do is to give you an opportunity, if you feel that you have been abused, to take it to the court and let them make the determination. I think that is the strong part of this bill.

You have not sought protection from the Federal Government or the local government to guarantee you anything—other than your day in court, which is an important part of the terminology that surrounds this bill.

I guess also I think we can put in the record now—for those who might not understand the situation, due to the complexities of the office machine business that you are in—there has been a rather dramatic change in just the last few years. Certainly I know that the history of the business that you are involved in started out, in the early processes, as a stationery store. You and your competitors, from the beginning, sold pencils, various forms of stationery, paperweights. And finally we began to evolve technologies that gave you an opportunity to broaden your field.

We now have reached a place where because of the high technology of office equipment in general, the new electronics, we have totally revolutionized this particular business within the last few years. What we have done, it seems to me, therefore, is put the average small businessman on the spot, not only from the standpoint of unreasonable demand with regard to quotas that have been made upon him by the various manufacturers, but also the tremendous expense that you have with carrying inventory at confiscatory interest rates—something you have have not mentioned, but I know probably, as much as anything else, is causing grave concern as to your ability to stay in business in the future.

So I think that those who may not understand the business should realize and recognize that there indeed has been a revolution in the way that your business operates. I was particularly interested in the testimony that has been given here this morning with regard to the expense that you have in sending your service representatives to schools. I remember well that this was always a concern of ours. There was hardly a month that went by that one or another of our suppliers, be they foreign or domestic, would come out with something new. It was not simply something that you could work in to your shop as you used to work in to the various typewriters; whether the typewriter came from Smith-Corona or whether it came from Olivetti, it was still a typewriter.

And if a serviceman could fix one, then he probably could fix another; essentially the same with such things as adding machines.

But I recognize now that with this specialization that we see in your industry you have the problem not only of the expense of the people going into school every 6 weeks to learn something new, you also have the additional expense of having that man or men, as highly trained as they are, out of your shop, not doing productive work—which is an important part of your business.

For those who do not understand the business, I am certain that it is generally true that if we ever could get to the place where the service department in your business breaks even, we would think that we have done an outstanding job. Quite often, as opposed to many other businesses and industries that could be cited, there usually is not any profit.

The service department, by and large, is an expense item. It is a tremendously important item as far as the success of your business and the satisfaction of your clientele with the service that you have rendered. Let me go into a couple of things, if I can.

Mr. Kuchta, if the disparity between the dealer and the manufacturer is as great as you described, how far do you think this bill will go to really achieve some measure of equalization?

Mr. KUCHTA. I think the bill really addresses the heart of the issue. I do not believe that a dealer agreement that I am coerced into signing, or having a choice of signing or going out of business, that says that I will pay maximum attorney fees, or that I can be canceled in 30 days, is fair and equitable.

And the heart of this bill is a good faith measure that says the manufacturer and the dealer will treat each other in a fair and equitable way. As long as we can have that good faith standard, then the courts—if there is an abuse that I feel is substantive enough to go to court—can handle it on a case-by-case basis. I feel it will address the issue very well.

Senator EXON. Mr. Van Gelder, while I was, of course, interested in yours and all of the excellent testimony that we received this morning, I would like to say that I have been involved in many, many hearings on many, many subjects—maybe it is because I know more about the subject that we are discussing here this morning than I do on many of the other things that we address here, but I want to compliment each of you for what I consider the most expert, to the point testimony that I have received.

Mr. Van Gelder, a question of you: There has been some criticism of the territorial restrictions provisions in S. 1256—I am sure you have looked at this from the beginning—of trying to fashion a bill that we thought was reasonable. We wanted reasonableness to be the key factor in the bill, and to have the courts eventually decide what is right and wrong.

What response do you have to any criticism that the territorial restrictions in the bill are not fair and equitable?

Mr. VAN GELDER. Senator, I feel that one of the major objects in our model dealer agreement was to establish territories so that we could have territory integrity, as well as fair and equitable quotas. Now, if we get into the Midwest and the Far West, with the exception of probably the populated coast States, 100 miles, as stipulated, is really a very fair request.

There are some concerns, I believe, in large cities, and that is where I feel that the model dealer agreement, the NOMDA agreement, which—is fair and equitable. It gives the opportunity for the manufacturer and the dealer to come to fair and agreed-upon quotas, and by doing this, it allows flexibility in that we would be able to understand each other as to what we are expected to do. Now, if for some reason or other I do not fulfill those quotas, then it is only right that I be canceled, or an additional dealer be added to that market area.

One of the central issues that we have here, as I see it, Senator, is that these multinational companies—they have an intense competition among themselves for market share, and they are constantly fighting for market share. I think that through the dealer agreement and the bill, if we can establish fair and equitable quotas and territorial integrity, there should be no problem.

Senator EXON. Thank you.

Mr. Nelson, question to you: Again, for the record, we need some input on this. Why don't dealers insist on getting a written contract?

Mr. NELSON. We do have written contracts.

Senator EXON. Do you always have written contracts?

Mr. NELSON. Today, generally speaking, there is a written contract. In fact, the Savin contract that John alluded to, that was their first written contract. They did not have one previous to that.

Senator EXON. Do I understand—if I could interrupt you for just a moment.

Do I understand, then, John, that when you first started doing business with Savin, you did not have a contract; is that correct?

Mr. KUCHTA. That's correct.

Senator EXON. When did they start the written contracts?

Mr. NELSON. May 10, 1979. We received a letter that stated if we do not sign and return this contract, unedited, by—it was May 17. And it had to be sent in by May 26, or we would not be shipped any product in the future. So we had a couple of days to act on this. And of course, you realize, it is impossible to take the high road at that point and say that we're not going to sign it, and not get any parts to service our client base.

Senator EXON. If you had not signed this contract, you would have no longer received parts or supplies?

Mr. NELSON. Right. And Savin has done that again on other contract—Sharp, by the way—Savin has a tendency to use the stick.

The Japanese manufacturers have a tendency to use the carrot. What Sharp did in the same situation was they said, "We are not going to be like Savin. You do not have to sign this new contract that we are presenting to you," in March 1979.

So we said, "That's fine. Who are you going to sell to?"

And they said, "We are only going to sell to our contracted dealers. But you don't have to sign this if you don't want to." That is their way of approaching this.

And one of the interesting things is that all of these contracts generally have time limits on them of 1 or 2 years, and that is one of the real problems that a dealer faces who makes this investment

and builds up the marketplace, and then at a 2-year point, for any reason, even if he is making quota, he can be summarily canceled.

Senator EXON. The point is, Mr. Nelson, there is no renewal option, really, on the part of the dealer at all. It is essentially all at the option of the manufacturer, as he views it.

Mr. NELSON. Right.

And I might add, you asked earlier—you asked John about are we going to end up as a very litigious group of people because of this law? I sense that what will happen is that there will probably be less lawsuits. I think when there is a radar car on the side of the road, those people on that part of the highway drive the speed limit. I think if this bill is passed, there will certainly be a sense of what the rules are, and how the game is to be played, and I think rather than less—rather than more lawsuits, there will be a fair play doctrine between all parties, and there will not be the need for lawsuits. It will be spelled out what the relationship should be.

Senator EXON. Mr. Israel, let's assume for a moment that the bill that we are discussing this morning does indeed become law. Let's say that it was law right now.

How would the provisions of this bill help you specifically in your problems in dealing with Norelco and Olivetti? How would you like to proceed if you had the option that hopefully eventually S. 1256 will give you as an independent dealer?

Mr. ISRAEL. I am glad you asked that question, Senator. I would say that the bill definitely will give us a chance to talk to Norelco, whereas now there is just nothing at all. In fact, if the bill were there they would not have taken, probably, this drastic action.

We need this. There was a time when we could have sold our business, perhaps—when you were fortunate enough to sell yours. You had something to sell: "I have such and such. Besides my inventory, good will—which does not mean that much—I have this line and this line and this line."

Well, today, they do not have to pass it on. In fact, I am worried about what they will do when my son is ready to take over. We are third generation, but they will say, "I do not have to give it to him because you had it for well over 20 years." I am in a little different spot than these other gentlemen. Some of them are Savin dealers and so forth of recent vintage. Our dealership goes back 20-odd years with these same people, and until they became like their other colleagues or their other competitors, they were treating us well, and we got along fine, even without a contract. And some years ago, they started with the contract business, which is fine. But I think definitely, to answer your question, there would not have been even the necessity of talking to Norelco, they signed a NOMDA model contract that never worked out, because since then NOMDA has retracted it, because of this very proposition that they were not actually living up to what they said.

Senator EXON. Thank you, Mr. Israel.

Mr. Jeitz, I would like to explore that point a bit further, if I might, and ask you a question. I suspect your answer is going to be in line with how I view this, and how it was amplified on, I think, by Mr. Israel a few moments ago.

My question basically is this: Legal affairs, as you well know, are often protracted and very costly these days. In your opinion, would

dealers be able to use the remedies afforded them in S. 1256, from a legal standpoint, or is it more likely that if this bill would become law, you probably would not have the necessity to go into court every so often, since you would have something on your side to at least approach the manufacturers and talk about a more reasonable attitude, rather than the rash of lawsuits.

Mr. JEITZ. Speaking personally, where we have had the problems, had we had this, the instance I mentioned with Saxon, I don't think there could have been anything done differently at that point. They would have been in court. We would have been able to take that situation in court, because we lost perhaps up to $100,000 on that particular instance alone. However, I think generally speaking, of all the various things I have indicated in my testimony, the fact that S. 1256, if it had been available, we would probably not have had the problems.

Senator EXON. One last question, which I will just throw it out and any of you can comment on it, if you will. I started out my questions with the statement thanking you for coming and saying that I suspected you were here not because you necessarily wanted to be, but you thought that you had no other course of action. Let me ask this question and you can comment on it at length, or say nothing, but short of this legislation, or something very similar to it, do you see any other possible solutions to the difficulties that you are here addressing? John?

Mr. KUCHTA. I think, as Mr. Van Gelder mentioned, we have sought help from various government regulatory agencies. We have gone to foreign countries to negotiate at arm's length with the manufacturers. We have talked to their American marketing companies. We have attempted to negotiate, but all of our negotiations to this point have fallen on deaf ears as a result of our negotiations, thus, the result of your help introducing this bill and this hearing today. I think this bill will help the office machine dealer and it is our only recourse at this point in time.

Mr. NELSON. I want to thank you, too. I appreciate your comments about the sensitivity of this issue about appearing here, because as we have grown to live with a lot of intimidation, this is really somewhat of a dice roll to show up here. This is bet your business, and it is a concern of ours because we are businessmen first and foremost, and we are volunteers through NOMDA. And yes, we have our own self-interests to protect, but we are doing this for others also. We were discussing last night that we expect to be contacted on the quality of our testimony——

Senator EXON. Let me interrupt you by saying when that happens, and if it happens, I would hope that you would pass along that information to us to help us in making these decisions.

Mr. NELSON. There is no question that you will be one of the first people I call, should that happen. I do appreciate that sensitivity. Not only has NOMDA gone to great lengths to negotiate, but as the chairman of the Sharp Advisory Council, I have spent hours upon hours negotiating on things like product testing and things like false claims on delivery that do not materialize. And in spite of the fact that dealers have threatened to cancel and threatened to sue, and pleaded and cajoled, just about every tactic that is available, we have been unable to get the manufacturers to respond.

Eighteen months ago when I started this process for NOMDA, we went to the White House and met with the National Security Council adviser, Donald Gregg, who was trying to educate us on dealing with the Japanese businessmen. He said, "Let me tell you what you are up against," and he said, "This is the way we feel about it, and I have been involved in this Japan desk for years. When the Japanese go to bed at night, they cancel your contract. When they wake up in the morning, they decide whether or not to renew it." He said, "That is the policy of doing business, and you're going to have to learn to live within that framework unless one thing occurs. They fear nothing but legislation."

Now, this man, I can only assume at that time, 18 months ago, was a spokesman for the Government. He certainly was a very studious person on the subject of Japan business affairs. Even beyond that, we still have tried to negotiate. Tom just came back from Japan with another go-around, but it has been terribly ineffective.

Senator EXON. Any other comment? I have nothing further, Mr. Chairman. Thank you, Mr. Chairman.

Senator PRESSLER [presiding]. Thank you.

Let me ask, why do you feel more manufacturers have not adopted the model dealer agreement which has been drafted by the National Office Machine Dealer's Association? Will this bill result in greater use of the model dealer agreement, in your opinion?

Mr. VAN GELDER. Yes, Mr. Chairman, I feel the bill will help set the benchmark standards of a relationship between the manufacturer of the goods and us as their viable link to the marketplace. If a benchmark is set, and I think in the bill it does give direction as to what is expected for fair and equitable treatment, that we will be in a position then to really sit down and set those standards.

Your first question, would you repeat that for me?

Senator PRESSLER. Why do you feel more manufacturers have not adopted the model dealer agreement, which I believe has been drafted by your association; is that right?

Mr. VAN GELDER. It is not in their best interest at this time. They have got it the way they want, as our testimony indicates this morning. For that reason, they have just done a stonewall job. There have been a few——

Senator PRESSLER. How lengthy is the model dealer agreement? Could we have a look at that for the record?

Mr. VAN GELDER. It is in my testimony; it is attached.[1]

Senator PRESSLER. All right. And what does it say, basically? You have already said it roughly, but can you boil it down? What is the model dealer agreement?

Mr. VAN GELDER. It says that we would like to deal with you and be treated fairly and equitably. It says in that contract that if we, the dealer, meet fair and equitable quotas, those to be agreed upon by the dealer and the manufacturers; if we send our people to school and have them trained at great expense to us, so that we can service their equipment; if we promote the goodwill in the community for that manufacturer, as far as him getting his market share, name recognition, then the other side of the coin is that we

[1] The agreement referred to was not reproducible but is in the subcommittee files.

would have continuing, ongoing relationship with them that would be noncancelable.

Let me use an analogy. If you were offered a Chevrolet agency and you spent three quarters of a million dollars to get the building, to hire your sales people, to get the product and have the service department developed properly, certainly when they said to you it is going to be a 1-year contract or a 2-year contract, it would make very easy—it would be very simple to make a decision. You would say no. Now, with us, we start with a product and we invest, over a period of 2 or 3 years, a considerable amount of money to develop that product, that name recognition, and we have a limited contract. We think it should be an asset that our efforts should be on a continuing, on-going basis, that it should be open-ended.

We feel also in that contract there is room for an appeals board, so that we can go to appeal. The manufacturer can appeal, as well as the dealer. And those mutually agreed upon quotas are certainly very, very important.

Senator EXON. Mr. Chairman, can I put in my 2 cents worth on this?

Senator PRESSLER. Certainly.

Senator EXON. I think the answer to your question as to why the manufacturers have not entered into model dealer agreements first is, as has been testified to, it is not in their interest. It is not in their interest for a number of reasons, and I suspect the main one is that if you have one manufacturer who would enter into a model dealer agreement, it would put that particular manufacturer at a disadvantage in the marketplace because he would be attempting to treat that dealer fairly and the other four dealers who do not have an agreement would be dealing with manufacturers who do not have such an agreement. And you would have an untenable situation as far as the free enterprise system in the marketplace is concerned.

That is the what S. 1256 is trying to address to give these gentlemen and those similarly situated, an opportunity to go into court if they don't think they are treated fairly, and have the judicial decision made there. And hopefully that would evolve to a place where we could put these important independent businessmen in America on a model dealer agreement, or something similar to it.

Is that not the answer, a legitimate answer to the question?

Mr. NELSON. This is the agreement. It is a simple 8½ by 11 agreement, two-sided. It says that the manufacturer and the dealer agree that throughout the term of this agreement, they will act in a fair, equitable and ethical manner to each other, as well as to the end user. The bottom line of the whole relationship is if I ever dared to treat my customer the way I am treated, I would have been out of business years ago, and that is the crux of the matter here and it cannot really continue.

Senator PRESSLER. Let me ask one final question. We have heard some references to the Japanese and other foreign manufacturers. Are the business practices of foreign manufacturers more abusive and unfair than those of American manufacturers?

Mr. KUCHTA. Mr. Chairman, I think all of us can answer that question on personal experiences alone. I believe it is unilateral.

Savin Corp. is an American firm. Yes, they import Japanese copiers and have been successful in selling it, marketing it here in the United States and in Canada. But in fact, they are an American corporation. Many of the Japanese corporations that have been discussed, Dutch corporations and so forth, have done a good job of marketing their products here in the States, but they unilaterally treat their dealers the same way as Senator Exon said. They have the upper hand. They have no need to treat us fairly and equitably.

Mr. JEITZ. There is one exception and I think we can bring it out. I know of one exception. It's not a company that I represent. It is called CPT. It is, I think, a Minneapolis-based company that sells word processors. I think many manufacturers could take a lesson from CPT because they have a super contract with their dealer. It does most things that we are asking in our dealer contract. They are one of the most successful word processing companies in the United States today. Every one of the dealers is super satisfied with the company, and that goes both ways. You will see them emerge as one of the major word processing companies around because they do it properly. So if others would take that lead, I think we could have the ideal situation—maybe not ideal, but at least a better situation in which to do business that is fair and equitable.

Mr. NELSON. I just became a dealer for Xerox Corp. While you were out of the room I had mentioned that some of the same situations are occurring with that company in terms of broken promises, delivery problems, and lack of fair and equitable treatment. And I might add that their contract does not call for a fair and equitable relationship and they purposely exclude from the contract. We have heard today about Japanese companies, Italian, Dutch companies, German companies, and generally speaking, it is a common experience. In fact, there was a company in Massachusetts, Dennison Manufacturing, that some of us have distributed for here. They decided to get out of the copy machine business and they sold their division to Saxon. And they said you can buy your parts now from Saxon, Mr. Nelson.

The average order to buy parts is 9 months, but Dennison has absolved themselves. It seems to be, as John said, a unilateral situation.

Senator PRESSLER. I thank the panel very much. You are five outstanding citizens and taxpayers who have experienced, as Senator Exon has, the problems of the office equipment industry and we thank you for sharing your expertise. We in Washington need more of your sort of thinking representing the small business world.

And we will now call on the next panel: Mr. Loren Steele, executive vice president, Super 8 Motels, Aberdeen, S. Dak.; Bruce C. Cotton, vice president, public affairs, Jerrico Inc., Lexington, Ky.; Robert R. Lynch, senior vice president, Radio Shack Dealer Division, Tandy Corp.

I might say that Mr. Steele is executive vice president of Super 8 Motels, which is a franchiser of lodging facilities. The first motel was built in 1974 in Aberdeen, S. Dak. They have 104 motels in operation in 17 States. That is an amazing record. We really appreciate your being here.

With that, I will first call on Mr. Steele, and may I say to the earlier panel, if you have additional thoughts or additional things to add to some of the questions, you can contact either Senator Exon or me and we will add it to the record. We really appreciate your being here.

Mr. Steele?

STATEMENT OF LOREN STEELE, EXECUTIVE VICE PRESIDENT, SUPER 8 MOTELS, ABERDEEN, S. DAK.

Mr. STEELE. Thank you, Senator Pressler. Mr. Chairman, members of the committee, my name is Loren Steele. I am executive vice president of Super 8 Motels, Inc., of Aberdeen, S. Dak. Super 8 is a franchiser of luxury economy lodging facilities. Our first property was constructed in Aberdeen in 1974. We presently have 104 motels in operation with another 12 under construction. In our home State of South Dakota we have 21 properties now operating. We employ probably 400 to 500 people.

Senator Exon, in our neighboring State of Nebraska we also have nine properties, with more to come. And your fine State is an integral part of our franchised system. As a franchiser we establish minimum standards as to the quality of the facility to be constructed, and in turn provides assistance to motel operations, training, marketing, public relations as well as quality control. We have small properties, as small as 31 rooms in smaller communities in the rural areas, and larger properties of up to 180 rooms in some of the metropolitan areas. The typical Super 8 franchisee is a small business person wishing to expand his portfolio, or possibly a former salaried employee who desires to be in business for himself or herself.

We have been well-received in the markets we serve. It is our intent to provide all normal amenities for the commercial and vacationing traveler: a full-sized room, TV, telephone, bath, shower, and toll-free reservations. Our customers normally pay 25 percent less than would be expected at a typical full-service hotel. The Super 8 franchise is granted for one location only with a radius of protection granted, depending upon the market area and upon individual negotiation with each franchisee. In rural communities in the upper Midwest, a franchise is normally granted to encompass an entire town, plus a radius of protection which averages 20 miles. In the metropolitan area a franchise might be granted for 1 or 2 miles, depending upon the certain market area. Within that radius we agree not to open another company-owned or franchised motel, but nothing precludes our franchisees from marketing or advertising in another town or community.

As I am sure you can understand, most of our customers are travelers from other cities and towns and not local residents. The success of our franchise system depends on a uniform and consistent quality image to the traveling public.

The main reason that our people join a franchise organization is to collectively market a lodging product and service. In most franchise organizations, Super 8 is no exception. It is very important that the chain serve as many markets as possible in order to maintain maximum exposure and benefit to all the franchisees. One form of assistance which we provide our franchisees is a

national advertising program through distribution of our national directory such as the one that is attached to your testimony.

We market our motels to the public through the country. I would like to refer today to S. 1256, entitled the Retail Dealers' Agreement Act. I am opposed to S. 1256, because as it is written, it would appear to unfairly regulate my company's franchising activities, as well as those of most other franchise organizations. I understand that the purpose of S. 1256 is to regulate problems related directly to the office equipment and office machinery business.

I would hope that a problem which now exists in that particular business would not cause legislation to be passed which would adversely affect many other business concerns arbitrarily. My greatest area of concern is as follows: It refers to a market area defined as 100 miles. As I mentioned, this would establish—we feel that this could establish a 100-mile veto power by existing franchisees. This would be extremely damaging to us.

At present our franchisees do have an area of protection to prevent unfair competition with another Super 8 property. To date, it has not been necessary to grant a radius of protection anywhere near 100 miles. In rural areas two entirely separate markets may be located less than 100 miles apart, both of which would provide successful Super 8 operations. To allow one or more franchisees the opportunity to control further development of the franchise system within 100 mile radius would adversely affect my company as well as our prospective franchisees.

It would be almost impossible for us to sell a franchise to an individual knowing that he might have to wait up to 2 years for a court proceeding to determine whether a proposed franchise could be granted. The 100-mile radius of protection could also provide an unfair competitive edge to the older, more established chains, franchise chains and prevent us from competing successfully with other motel chains which are more established in certain markets.

For instance, there are two chains on the east coast which have saturated the metropolitan areas from Miami to New York. Now that we're in a position and wish to develop properties on the east coast, it would be difficult for us to locate one every 100 miles and feel that it would prevent us from getting the share of the market that we think could be available to us.

I understand that some people could argue that our radius policy would provide protection only within the radius we have given; however, because the bill defines a market area as a dealer's geographic selling area of responsibility as defined in the dealer agreement, and we advertise and sell our services throughout the country, the definition may not apply to us. We do not actually designate a selling area.

If the radius we give is designated a market area, then that would give Super 8 a competitive advantage in many markets where our major competitors provide no radius or other form of market area, even though their franchisees could preclude their expansion to within 100 miles while we entered the market with 5 or 20 mile protection areas. I don't believe such a competitive advantage is necessary for my company, fair or in the long term best interest of my industry.

The second concern is the agreement termination provision. S. 1256 refers to several conditions to be met at the time the agreement is terminated or canceled. Super 8 Motels, Inc., offers a 20-year franchise agreement at the present time. There are no provisions for renewal in our agreement. We believe this to be the standard practice in motel franchising. If we were required to provide compensation for good will to a former franchisee, it would place a substantial contingent liability on the financial condition of the franchiser. We believe our 20-year agreement allows our franchisees sufficient time to make a reasonable return on his investment, plus pay for the asset itself. We do not feel it fair and equitable to us to be forced to offer additional compensation at the end of the agreement.

Again, I wish to assure you that I understand that this legislation is being considered to provide protection to the retail office equipment dealer. I also understand that the bill is probably not intended to affect me at all. I do remain concerned, however, with the precedent that legislation such as S. 1256 could set. If this legislation is reworded to more directly pertain to the office equipment industry and then enacted, I still fear that similar legislation will come along soon to further restrict me as a franchisor.

I respectfully suggest that present laws and regulations in the franchising industry provide sufficient protection to the franchisees and franchisors. Perhaps full disclosure or some other kind of legislation would encourage the fairness that seems to be lacking in the office equipment industry. Establishing 100 monopolies is a bad approach. We at Super 8 fully realize that in order for us to be successful, our franchisees have to be successful also. It is within that spirit that we operate our chain and are pleased to say that it has worked well so far.

I appreciate the opportunity to be here and to testify before you gentlemen today.

Thank you.

[The statement follows:]

STATEMENT OF LOREN D. STEELE, EXECUTIVE VICE PRESIDENT, SUPER 8 MOTELS, INC., ABERDEEN, S. DAK.

Mr. Chairman and members of the Committee:

My name is Loren Steele and I am Executive Vice President of Super 8 Motels, Inc. of Aberdeen, South Dakota. Super 8 Motels, Inc. is a franchisor of luxury economy lodging facilities. Our first motel was built in 1974 in Aberdeen, South Dakota and we presently have 104 motels in operation in 17 states. In addition, we have another 12 motels under construction at the present time.

Our franchise chain started in the upper midwest, mainly in the Dakotas, Nebraska and Minnesota. While the heart of our chain remains in this area, we now have five properties open in California, two in New York State and do serve other states such as Ohio, Florida and Texas.

As a franchisor, Super 8 Motels, Inc. establishes minimum standards as to the quality of the facility to be constructed and in turn provides assistance in motel operations, training, marketing and public relations, as well as quality control. Our properties range in size from 31 rooms in smaller communities to 180 rooms in some metropolitan areas. The typical Super 8 franchisee is a small businessperson wishing to expand his portfolio or possibly a former salaried employee who desires to own a business.

The Super 8 concept has been well received in the markets that we presently serve. It is our intent to provide all normal amenities required by today's business or vacationing traveler, mainly a full-sized room with free color T.V., direct dial telephones, bath/shower combinations and toll free reservations. Our customers

normally pay at least 25 percent less than would be expected at a typical full-service lodging property.

The Super 8 Motel franchise is granted for one location only with the radius of protection granted depending on the market area and upon individual negotiation with each franchisee. In rural communities in the upper midwest, the franchise is normally granted to encompass an entire town plus a radius of protection which averages 20 miles. In metropolitan areas, a franchise will be granted for one location with a radius of protection from one to five miles depending on market area. Within that radius Super 8 agrees not to open another company owned or franchised motel. But nothing precludes one of our franchisees from advertising in another town. As I'm sure you can understand, most of our customers are travelers from other cities and towns, not local residents.

The success of our franchise system depends largely on a uniform, consistent, and quality image provided to the traveling public by our franchisees. The main reasons that our people have joined a franchise organization is to collectively market a lodging product and service. In most franchise organizations, and Super 8 is no exception, it is very important that the chain serve as many markets as possible in order to maintain maximum exposure and benefit to all franchisees. One form of assistance we provide our franchisees is our national advertising program. Through distribution of our national directory, such as the one attached, we market our motels to the public throughout the country.

Senate Bill 1256—"Retail Dealers' Agreement Act":

I am opposed to S. 1256 because, as it is written, it would appear to unfairly regulate my company's franchising activities as well as those of most other franchising organizations.

I understand that the purpose of S. 1256 is to regulate problems related directly to the office machinery business. I would hope that a problem which now exists in that particular business would not cause legislation to be passed which would adversely affect many other business concerns arbitrarily.

Mr areas of greatest concern are as follow:

I. MARKET AREA DEFINED AS 100 MILES

The clause, which would establish a 100 mile veto power by existing franchisees, would be extremely damaging to us. At present, our franchisees do have an area of protection to prevent unfair competition with another Super 8 property. To date, it has not been necessary to grant a radius of protection anywhere near 100 miles. In rural areas, two entirely separate markets may be located less than 100 miles apart, both of which would provide successful Super 8 operations. To allow one or more franchisees the opportunity to control further development of the franchise system within a 100 mile radius would adversely affect my company as well as our prospective franchisees. It would be almost impossible for us to sell a franchise to an individual knowing that he may have to wait up to two years for a court decision to determine whether a proposed franchise could be granted.

S. 1256 would also provide an unfair competitive edge to the older, more established franchise chains. This bill would prevent us from competing successfully with other motel chains which are more established in certain market areas. For instance, there are two economy motel franchise chains based here on the east coast which have a large number of properties which saturate the metropolitan areas from Miami to New York City. Now that Super 8 is ready to develop in the east coast, this law could limit us to one motel every 100 miles, making it extremely difficult to gain a share of the market which we feel could be available to us.

I understand that some people could argue that our radius policy would provide protection only within the radius we have given. However, because the bill defines a market area as "a dealer's geographic selling area of responsibility as defined in the dealer agreement . . . ," and we advertise and sell our services throughout the country, the definition may not apply to us. We don't actually designate a "selling area".

Of course, if the radius we give is designated a "market area", then that would give Super 8 a competitive advantage in many markets where our major competitors provide no radius or other form of "market area." Even though their franchisees could preclude their expansion to within 100 miles, while we entered the market with five or twenty mile protected areas, I don't believe such a competitive advantage is necessary for my company, fair, or in the long-term best interest of my industry.

II. AGREEMENT TERMINATION

Senate Bill 1256 refers to several conditions to be met at the time the agreement is terminated or cancelled. Super 8 Motels, Inc. offers a 20 year franchise agreement at the present time. There are no provisions for renewal in our agreement. We believe this to be a standard practice in motel franchising. If we were required to provide compensation for good will to a former franchisee, it would place a substantial contingent liability on the financial condition of the franchisor. We believe that our 20 year agreement allows our franchisee sufficient time to make a reasonable return on his investment plus pay for the asset itself. We do not feel it fair and equitable to us to be forced to offer additional compensation at the end of the agreement.

Again, I wish to assure you that I understand that this legislation is being considered to provide protection to the retail office equipment dealer. I also understand that the bill was probably not intended to affect me at all. I do remain concerned, however, with the precedent that legislation such as S. 1256 could set. If this legislation is reworded to more directly pertain to the office equipment industry and then enacted, I still fear that similar legislation will come along soon to further restrict me as a franchisor. I respectfully suggest that present laws and regulations in the franchising industry provide sufficient protection to the franchisees. Perhaps full disclosure or some other kind of legislation would encourage the fairness that seems to be lacking in the office equipment industry. Establishing 100 mile monopolies is a bad approach.

We at Super 8 fully realize that in order for us to be successful, our franchisees have to be successful also. It is within that spirit that we operate our chain and we are pleased to say that it has worked well so far. I appreciate the opportunity to appear before you today and present my thoughts. Gentlemen, thank you.

SUPER 8 MOTELS, INC.,
Aberdeen, S. Dak., November 6, 1981.

Senator LARRY PRESSLER,
Chairman, U.S. Senate Subcommittee on Business, Trade and Tourism, Washington, D.C.

DEAR SENATOR PRESSLER: Thank you for your letter of November 2, 1981 which encloses additional questions submitted for the record by Senator James Exon. Set forth below are my answers.

Question number one refers to the Soft Drink Interbrand Competition Act. As I understand the Soft Drink Bill, it allows the parties to negotiate an area of protection if they choose to but does not force them to do so. As I understand S. 1256 if the parties fail to negotiate an area of protection the Bill would automatically establish this area. I do not feel that this is equitable or necessary.

Question number two refers to free negotiation between manufacturers and dealers. I do support free and individual negotiation between manufacturers and dealers or franchisors and franchisees as long as constraints are not placed upon either party to a negotiation.

Question number three refers to a 20 mile radius of protection rather than 100 miles. It is impossible to establish one distance of limitation that would adequately apply to all situations. In my case, a 20 mile radius of protection works well in several markets, however, it would still be too restrictive in Metropolitan areas such as Houston or Miami. Each market is different and should be established and negotiated independently by the parties involved.

All of the above is respectfully submitted.

Sincerely,

LOREN STEELE,
Executive Vice President.

Senator PRESSLER. Thank you. Senator Exon will now ask a few questions. The Senator may have to leave.

Senator EXON. Thank you for coming, Mr. Steele. I try to put myself in other people's shoes, and I suspect if I were in your shoes, I would be there saying the same thing that you are. I do feel when those of us up here start passing laws that everybody should be alerted to the situation that it is not going to do something that we do not intend. And certainly I think I made it clear

in my opening statement that this was not intended to cover any of the areas that you, and as I understand it, the other members sitting at the table there now have concerns about.

I would just emphasize once again that I appreciate your testimony, and we will take it into consideration. There are specific changes in language in addition to those that you suggested this morning. We will be glad to take those into consideration. We can amend this bill very easily, either before we pass it, which I think we will, or it could be amended on the floor. We do that in the initial instance whenever we can.

Two of the things that you bring up I suspect are pretty well specifically covered right now. In the first, you have concern about the 100-mile territory. I think I understand your concerns. It seems to me though that we say as part of the bill that it had to do with retail office machines only. But we say in the bill "market area" means the dealer's geographic area of responsibility as defined in the agreement. I don't know how you specify that in your dealer agreement. It would seem to me it would be a relatively simple matter for you to so specify in the dealer agreement or whatever you call your franchising arrangement.

You have a 20-year agreement which is certainly long term and gives some protection to the people that are buying the services you perform and probably should not be covered by this act because what we are specifically trying to get at are the short-term arrangements that are made or no agreement at all. That puts these independent businessmen really out on a limb that can be sawed off.

If you have a 20-year agreement with me that is specified, I suspect if it is reasonable and a fair agreement, then this act would cause you no trouble.

But I would just say again, if you have suggestions in that area, we would be glad to consider them.

Mr. STEELE. Thank you. The International Franchisers Association, which is the group I am here as a part of, I am sure will be in touch with you on that.

Senator PRESSLER. Next we will hear fom Bruce Cotton, vice president for public affairs of Jerrico, Inc., on behalf of the International Franchise Association. Mr. Cotton.

STATEMENT OF BRUCE C. COTTON, VICE PRESIDENT, PUBLIC AFFAIRS, JERRICO, INC., LEXINGTON, KY.

Mr. COTTON. Thank you, Mr. Chairman.

Senator Exon, the last time we talked, I think you were attending a Governor's Conference in the beautiful State of Kentucky.

Senator EXON. I thought I recognized you.

Mr. COTTON. I am sorry to meet you under these circumstances.

There is one handicap in going last in presenting testimony as a witness. The five distinguished witnesses that preceded me convinced me without a doubt that they have a problem. They have a problem within their industry and apparently a problem with our allies. So I hope you all in your wisdom can resolve their problem, because I'm leaving here this morning convinced that they do have a problem.

I am vice president for public affairs, Jerrico, Inc., in Lexington, Ky. We operate two restaurant chains, 75 Jerry's restaurants in 6 Southeastern States, 1,157 restaurants in 38 States, Long John Silver Seafood Shoppes. They are 60 percent company owned and 40 percent franchised. Our systemwide sales were approximately $507 million this last year. Our company franchisely employs 16,000 people.

I am also appearing today on behalf of the International Franchise Association of which I am second vice president. I also chair the association's membership committee and the franchising political action committee.

With me today to keep me out of trouble, basically, is Mr. Zwisler, IFA's general counsel.

The IFA is an organization of over 60 companies for three dozen industries who use the franchising system of distributing their products and services. International franchising accounts for one-third of all retail sales. It's responsible for 460,000 business units and has provided successful business opportunities to nearly 400,000 men and women; 4½ million Americans are employed directly as the result of franchising.

Nonetheless franchising is predominantly small business; 65 percent of franchisers have fewer than 50 units. IFA members are both large and small and operate throughout all of the United States.

We have submitted along with a detailed testimony of mine, a classified directory of members and a franchising package sheet which you will have. We represent small business, and we rely upon other successful small businesses for our livelihood, and we have a serious concern for practices and legislation which affect small businesses.

We sympathize and after this morning empathize with the problems of the office machinery dealers, and we have no opposition to their point of concern; however, we believe S. 1256, as drafted, is too far-reaching a proposal for these problems. We question if it will solve the problems as written.

Jerrico, IFA oppose S. 1256 as drafted for two principal reasons. First, the definition of dealership as presently drafted in such a manner that it regulates the franchise relationship of most IFA members, including my company. That is because franchisors provide products or services to their franchisees for use in a business or office environment.

Second, the proposed restraints upon establishment of new franchisees or dealerships would establish a very radical and disagreeable precedent for franchising. We have spoken with representatives of the bill's principal proponents, NOMDA, who agreed that our franchisers and franchisees should not be subject to the bill. We have agreed to try to work with them to develop a dealership definition which will reflect their concerns and not cover franchisors.

I must point out that distinguishing office machinery dealerships from other selective distribution arrangements may not be easy. My company, like every other franchisor of IFA, is required to provide a full disclosure to every prospective franchisee to meet our obligations under the FTC's franchising trade rule regulation.

That document tells our company's policies about termination, nonrenewal and territorial protection. Every prospective franchisee must receive a disclosure statement at least 10 business days before he can sign a franchise agreement or pay us any money whatsoever. This document contains specific information about a franchisor's policy and track record concerning the various subjects addressed by S. 1256. We believe the FTC regulation provides substantial protection to franchisees and that further regulation is unwarranted.

We believe that the problems which exist in the office machinery industry do not extend to other industries, neither should the application of S. 1256.

In our opinion, the best approach to economic regulation is through free and vigorous competition in the marketplace. In franchising, some companies grant exclusive or protected territories for their franchisees or dealers, while others grant franchisees for specific locations only. A prospective franchisee who believes an interbrand competitive protection is important, has the opportunity to select that kind of franchising system over systems which do not provide that, or he can negotiate with his franchisor.

The fact is that franchisors' policies differ and franchisees can choose from 1,400 different franchisee programs.

Let me make one point clear. After all material terms of a franchise agreement have been disclosed and an agreement to those terms is reached, the Government should restrain from changing those standards, absent some compelling evidence of a pattern of abuse by one of these parties.

Even under such circumstances, Government regulation is only warranted if the problem is pervasive within an industry and no suitable remedy exists.

The most striking figure of S. 1256 is that it could establish dealer cartels for the sale of products and services over an area of nearly 31,000 square miles per dealer. Even if the legislation were designed to provide such protection for just a 25-square-mile area, we would be forced to oppose the idea. Our members have learned through expensive litigation that measures designed to restrict competition among our franchisees are discouraged by antitrust laws.

For example, Holiday Inn's policy of consulting with nearby franchisees before granting a new hotel franchise was declared unlawful by a Federal circuit court. That lawsuit cost the franchiser several million dollars.

After all the lawsuits that have been brought against franchisers challenging the franchisee placement policies and the commendable efforts of Congress to deregulate business, we are surprised at the broad approach of S. 1256 as drafted—that it would receive serious consideration. We seriously doubt that Federal circuit courts or Government agencies are prepared to make better marketing decisions than franchisers or manufacturers currently make.

We believe the proposals to establish protective territories is unfair to dealers and franchisees, especially those that would hope some day to expand their own businesses. By protecting one class of businessman from competition by another, the legislation con-

dones inefficiencies and high prices. It invites vertical integration and elimination of independent dealers.

In conclusion, we feel that S. 1256 must be narrowed to apply exclusively to the office machinery industry, and we support that wholeheartedly. It is wholly inappropriate to apply it to all forms of franchisees and dealer/shipper agreements.

Should the committee decide that some form of protection is necessary for the office machinery dealers, we suggest a very critical look at the concept proposed in this legislation of establishing dealer cartels. We believe that such a remedy is radical and unnecessary to deal with most of the problems within any industry.

Finally, the legislation raises many technical issues which should be resolved by this subcommittee before further action is considered.

We thank you for the opportunity to present our views to you, and we are willing to answer any questions which you may have.

I would like to further state, Mr. Chairman, our association stands ready to work with NOMDA and with this committee and particularly with Senator Exon to resolve our differences equitably concerning the definition of who might be covered under S. 1256.

[The statement follows:]

STATEMENT OF BRUCE C. COTTON, VICE PRESIDENT FOR PUBLIC AFFAIRS OF JERRICO, INC., LEXINGTON, KY., ON BEHALF OF THE INTERNATIONAL FRANCHISE ASSOCIATION, WASHINGTON, D.C.

Good morning, Mr. Chairman and members of the Committee. My name is Bruce C. Cotton. I am vice president for public affairs of Jerrico, Inc., Lexington, Kentucky. Jerrico operates two restaurant chains, the Jerry's Restaurants chain of 75 restaurants in six southeastern states, and the Long John Silver's Seafood Shoppe chain of 1,157 restaurants in 38 states. Our Jerrico restaurants are 60 percent company-owned and 40 percent franchised. Our systemwide sales were approximately $506,666,000 during last year. Our company and our franchisees employ in excess of 16,000 people.

I'm also appearing today on behalf of the International Franchise Association (IFA) of which I am second vice president. I also chair the Association's Membership Committee and the Franchising Political Action Committee.

The International Franchise Association is an organization of over 360 companies from more than three dozen industries who use the franchising system of distributing their products and services. Nationally, franchising accounts for nearly one-third of all retail sales, is responsible for 460,000 business units, and has provided successful business opportunities to nearly 400,000 men and women. Four and one-half million Americans are employed directly as a result of franchising. Nonetheless, franchising is predominantly small business. Eighty-two percent of all franchisors have fewer than 150 units and sixty-five percent have fewer than fifty units. IFA's members are both large and small and operate throughout all of the United States. A classified directory of members is attached.

Jerrico and IFA oppose Senate Bill 1256 as drafted for two principle reasons. First, the definition of dealership is presently drafted in such a manner as to regulate the franchise relationships of most IFA members, including my company. That is because most franchisors provide products or services to their franchisees for "use in a business or office environment."

Second, the proposed restraints upon establishment of new franchises or dealerships would establish a most disagreeable precedent, which we fear would be harmful to franchisors and franchisees, both as consumers of office machines and products, and as businessmen who may some day be the targets of similar inappropriate legislation.

IFA members fall into two distinct categories: franchisor members, often defined as business format franchisors, and distributor members, companies which are not formally recognized as franchises nor regulated as such. Long John Silver's, Super 8 Motels, and Radio Shack are examples of business format franchisors which are subject, for example, to the Federal Trade Commission's franchising trade regulation rule. General Motors, a company which is exempt from the FTC rule, is an

example of a member of our distributor division. Companies eligible for membership in our distributor division generally distribute their products or services using a selective distribution format whereby they designate only a limited number of retailers in a given area to sell and service their products. Normally, unlike their franchising brothers, the selective distributors do not charge a franchise fee; rather, they sell goods to the retailers at a bona fide wholesale price and derive their profits principally from the sales of goods.

We emphasize the methods of distribution used by our members so that it will be easy to identify them if the Committee agrees that the legislation should be redrafted to apply solely to the industry alleging the need for regulation.

My company, Jerrico, like every other franchisor member of IFA, is required to provide a full disclosure document to every prospective franchisee to meet our obligations under the Federal Trade Commission's franchising trade regulation rule. In that document we must describe our company's policies about termination, nonrenewal and territorial protection. At least ten business days before one of our prospective franchisees can sign a franchise agreement or pay any money towards establishment of a franchise relationship, the prospective franchisee must have a copy of this disclosure statement in hand. Our purpose is to permit him to review the document so that he can intelligently decide whether our franchises are appropriate for him. This document contains explicit information about territorial protection, termination, nonrenewal and litigation history, the very subjects addressed by S. 1256. We believe that this regulation provides substantial protection to franchisees of our franchisor members and that further regulation is unwarranted. IFA distributor members operate in industries such as the automotive industry, and are governed by special industry rules. The problems which are alleged to exist in the office machinery industry do not extend to other industries. Neither should the application of S. 1256.

The rest of our comments relate to the concept of providing cartel-like protection for retailers and technical problems raised by the bill itself.

In our opinion, the best approach to economic regulation is through free and vigorous competition in the marketplace. In our forms of business, for example, some companies choose to provide exclusive or protected territories for their franchisees or dealers, while others find that the success of their marketing programs is dependent upon non-exclusivity. A prospective franchisee or dealer who believes that some sort of intrabrand competitive protection is important has the opportunity to select that type of franchising system over systems which do not provide it. We are firmly committed to the concept that after full disclosure of all material terms of a franchise agreement, and an agreement to those terms is reached, the government should refrain from changing those standards, absent some compelling evidence of a pattern of abuse by one of the parties. Even under such circumstances, government regulation is only warranted if the problem is pervasive within an industry and no suitable remedy exists.

We further believe that all franchisees and dealers who enter into an agreement with a franchisor recognize the basic operational tenets of the company and rely upon the franchisor's right and duty to enforce the agreement against those who would stray from the standards that give every franchise an identity and uniformity. For example, S. 1256 purports to regulate the ability of a manufacturer or franchisor to terminate, refuse to renew, or establish a new dealership. The legislation would cause radical change to the expectations of all parties to an agreement. Under S. 1256, franchisees given a five-year non-exclusive contract suddenly become the holders of perpetual, exclusive arrangements. We can conceive of no need for this form of regulation of our members and our franchisees.

DEALER CARTELS

The most striking feature of S. 1256 is that in many cases it would establish dealer cartels for the sale of products and services over an area of nearly 31,000 square miles per dealer. Even if the legislation were designed to provide such protection for just a 25 square mile area, we would be forced to express our serious concern about the wisdom of such a proposal.

We note that since passage of the Sherman Act in 1890 Congress has time and again advocated a free market competitive economy as the law of the land. At various times during our history, not only have horizontal territorial allocations been condemned as per se violations of the antitrust law, carrying with them criminal penalties and treble damage sanctions, but so too have been vertical territorial restraints imposed by manufacturers or franchisors over the sales of products by independent dealers and distributors.

Our members have learned through expensive litigation that measures designed to restrict competition among our franchisees is discouraged by the antitrust law. For example, Holiday Inns' policy of consulting with nearby franchisees before granting a new hotel franchise was declared unlawful by a federal circuit court. *American Motor Inns, Inc.* v. *Holiday Inns, Inc.*, 521 f2d 1230 (3rd Cir., 1975). Schwinn's exclusive dealership arrangements were also held unlawful by the Supreme Court. *United States* v. *Arnold Schwinn and Co.*, 388 U.S. 365 (1967).

IFA applauded the reversal of this per se doctrine regarding vertical restraints when the Supreme Court in *GTE Sylvania* v. *Continental TV Inc.* 97 S.Ct. 2549 (1977), overturned the ten year tenure of the *Schwinn* decision. Recognizing that territorial and customer restraints, especially when vertically imposed, are often pro-competitive in nature, IFA, as amicus curiae, sought the very result the ccurt reached in that case.

Against that background, we find it most incongruous that Congress would propose for one industry or many industries (depending upon the ultimate definition of dealer agreement) to create a weapon whereby individual dealers could singlehandedly preclude intrabrand competition for a number of years and simultaneously confiscate long-term territorial protection rights from manufacturers and franchisors that were never within the reasonable anticipation of the parties when the agreements were negotiated. It is most ironic that in an era of deregulation when Congress' attention has been focused on eliminating competitive barriers in the trucking and airline industries that Congress would seriously consider protecting existing dealers from competition from individuals who are more aggressive or willing to take risks, and who have not previously had the ability or opportunity to own their own businesses. We believe barriers to business entry of this type are simply unwarranted.

We note from Senator Exon's introductory remarks that office machinery dealers pick and choose among manufacturers. Understandably, they seek the most economically profitable deal they can find in order to maximize their profits. Paradoxically, this legislation would preclude the manufacturers from also seeking to maximize their profits by finding more competent, more aggresive, or just plain new dealers who would also satisfy their economic objectives.

As a matter of principle, we object to the Congress or any government agency making marketing decisions for private businessmen. We seriously doubt that federal district courts or any government agencies are prepared to make such decisions in a way which is better for consumers, dealers, franchisees, manufacturers, or franchisors than the current franchisor-franchisee negotiations. Our membership is comprised of many companies that have been started in the last three decades by individuals who used creative ideas and methods to establish companies which are today major household words. Yet, when they conceived the notion, we doubt that many judges or bureaucrats with decision-making authority would have permitted them to engage in something so novel or untested.

We believe the proposal to establish protective territories is unfair to dealers and franchisees, especially those who would hope someday to expand their own businesses. By protecting one class of businessmen from competition by another, legislation condones inefficiencies and high prices. While it protects a company from loss of one of its product lines, it stifles an aggressive competitior in his or her attempt to provide a better service and price.

Manufacturers and franchisors also find themselves confronted with a dilemma. Unable to react to a changing marketplace and allocate marketing priorities as consumer demand suggests they should be allocated, we suspect that many manufacturers or franchisors would choose to vertically integrate their channels of distribution, rather than to be unceremoniously hauled into court each time they propose a new dealer agreement, terminate a product line, or otherwise adjust their marketing program. Moreover, we cannot help but wonder what impact such a proposal as S. 1256 would have upon the competitive position of the large national merchandising chains which already compete in virtually every aspect of the retail trade.

Artificial government regulations could induce many manufacturers and distributors to use national retailing chains to distribute their products and services. Carrying with it the advantage of a single purchase contract, the chains, such as Sears or K-Mart, could become dealers of a particular brand of equipment and preclude competition by the independents throughout the country.

In summary, we can only conclude that legislatively mandated protected territories serve only to provide short-term protection for some retailers at the expense of consumers, new retailers, manufacturers, and franchisors. The proposed remedy to the problems within the office machinery industry is so extraordinary that we recommend a very close, hard look at the problems within the industry to determine if anything short of this type of legislation could better solve the industry's

problems. We urge the subcommittee to totally reject applications of this priniciple to franchised distribution.

DRAFTING ISSUES

Dealers

The dealer definition is extremely broad. Not only does it encompasss virtually all sales by a manufacturer to a retailer where the product or service is used in an office or business environment, it also applies to each agreement that any particular retailer may have with a wholesaler, distributor or manufacturer. As Senator Exon notes at S 5520 of his introductory remarks in the Congressional Recored, "Rather than being married to one manufacturer's product, he represents a mix of manufacturers, prescreening and selection (sic) only those that can be blended to provide appropriate equipment for this customers' needs." It is conceivable that more than 100 products may be carried by an individual dealer and that each such product line could be the subject of a separate dealer agreement. If the office machinery dealers do, in fact, require legislative protection, we recommend that they more closely define the interest which they seek to protect in the legislation itself.

Market area

Defining market area as the area within 100 miles of the dealer's primary place of business immediately gives a dealer protection over approximately 31,400 square miles. By simply drawing a 100-mile radius from Washington, D.C., a dealer would gain rights over the supply of products covered by the legislation not only in the Washington metropolitan area, but also in the Baltimore, Wilmington, Richmond and perhaps part of the Philadelphia metropolitan areas. Section 2.12 also defines a market area as "the dealer's geographic selling area of responsibility as defined in the dealer agreement." It is unclear to us whether this refers to an exclusive territory, a primary area of responsibility, a street address, or something else.

It also occurs to us that a sales area may not be an exclusive sales area. Several dealers may sell products in the same metropolitan area. (For example, in Washington, D.C. 1981 Yellow Pages, in four pages of listings of calculators the Sharp name appears in ten display ads.)

The definition also seems to create a marketing area or primary sales area when none was intended by the parties in developing their contract. If an exclusive territory was neither sought nor agreed to by the suppliers and the dealers, it seems inappropriate for Congress to make such an award to a dealer.

Good faith

This concept is defined in a way which approaches, but which is not fully consistent with, the Auto Dealers' Day in Court Act, 15 USC 1221(e). The draftsman, who calls attention to the parallels between the proposed legislation and the Auto Dealers Franchise Act, has failed to include the following proviso in his definition of good faith, "provided, that recommendation, endorsement, exposition, persuasion, urging, or argument shall not be deemed to constitute a lack of good faith."

The requirement that a supplier act in good faith in cancelling or refusing to renew a dealership is also difficult to interpret inasmuch as a termination may be a unilateral decision by a supplier to withhold future business because of failure by the dealer to comply with the requirements of the dealer agreement. Communication of the need to comply with reference to the powers of termination could be deemed coercive or intimidating. One would hope that is not the intention of the author.

Notice

Section 3.(a)(4) would preclude the establishment of another dealer agreement before at least sixty days has elapsed and the existing dealer of the same product has failed to object. If the dealer does object, in accordance with Section 3.(b)(1), the legislation is silent about whether the new dealership may be established. Carrying as it does a threat of injunctive relief and treble damages (Section 6), the legislation could effectively preclude establishment of the new dealership until a federal district court has had time to review all of the facts presented by both parties. The delay could run in excess of two years. This delay alone would be enough to thwart the incentive of many manufacturers to establish new dealer agreements.

Objections

Section 3.(b)(1) authorizes a dealer to object in a "timely manner". Is that within the 60 days identified in the preceding paragraph? If the dealer does object, must an injunction issue? Must there be a hearing to determine whether an injunction should issue? If a supplier does establish a dealership after objection has been

received, but before a court decides whether the dealership may be granted, is establishment of the dealership a willful violation as described in Section 6, carrying with it treble damage liability as well as liability for court costs and attorneys' fees?

To whom is the objection to be made? To the supplier? To the federal district court? To both? If an existing dealer proposes to relocate his dealership or to sell it to a third party buyer, can the remedies of Section 3 be invoked? The impact on the dealers could be quite severe.

We also wonder whether a proposed dealership is the same as a proposed dealer agreement. Section 3(b)(1) would seem to place the decision as to the propriety of establishment of a proposed dealership in the hands of the supplier with ultimate review by the courts. Yet, that interpretation is at variance with the remainder of the bill. Some clarification would be appropriate.

Pertinent circumstances

Subparagraphs A through G are apparently a nonexclusive list of factors that a court can consider in evaluating a supplier's decision. Currently, F would be the most prominent factor in the decision of most manufacturers, in that if they have granted an exclusive territory they will honor it. However, if they explicitly state that the dealer does not receive an exclusive marketing area, they generally intend to retain their option to establish new dealerships. We must wonder whether this legislation contemplates a declaratory judgment action whereby a supplier could have his marekting program and his dealership policies upheld on a nationwide basis before commencing to establish any new dealerships.

We also note that under the procedures prescribed by this legislation, certain manufacturers, suppliers or franchisors, if governed, would be able to engage in conduct which has been declared unlawful by federal district courts under the Sherman Act. For example, in the case of *American Motor Inns* v. *Holiday Inns* (supra), the third circuit court of appeals found that the Holiday Inns' policy of sending a radius letter to each of its nearby franchisees before approving a new location for a new franchise, and subsequently acting based upon the response of the existing franchisees, was a per se violation of the Sherman Act. This legislation would require similar notices to be sent to dealers and authorize the courts to serve as the ultimate arbiter of whether a decision to establish a new dealership or franchise is appropriate.

Termination

Section 3.(b)(4) permits termination, cancellation or refusal to renew a dealer agreement only if the supplier offers to compensate the dealer for the "value of the dealer agreement to the dealership, including a reasonable amount for good will." What is the value of a dealer agreement that has a defined one-year term, upon its expiration? If a dealer carriers 200 products, how is the good will determined for each product upon termination? If the dealer is terminated or not renewed for good cause, what is the basis for exacting any payment from the supplier?

The legislation would seem to impose an obligation on a supplier to compensate a dealer for terminating or refusing to renew an agreement to sell products which have met with unfavorable consumer response. This legislation would then allocate the risk of loss under such circumstances solely to the suppliers.

If a dealer pays nothing for a dealer agreement, how is it value to be ascertained? It would seem that by refusing to pay its bills, a dealership could close down and receive compensation which far exceeds the actual value of the business as a going concern.

We also note that it is important to establish different conditions and obligations for termination than for nonrenewal.

Civil actions

Section 6 provides for a recovery of treble damages, court costs, and attorneys' fees if a violation is willful. Establishing a new dealership would seem to be willful on almost every occasion, as would be termination or nonrenewal of an existing dealership. The sanctions seem strikingly high for the redress of a new civil right. The only comparable recovery with which we are familiar is a recovery for violation of the antitrust laws. In those situations, private plantiffs are serving as private attorneys general to prosecute the public's interest in maintaining vigorous competition. We doubt that a similar interest is being vindicated in lawsuits which might be brought pursuant to this legislation. Moreover, we question the desirability of a dealer to recover court costs and attorneys' fees if successful, when a mutual right is not provided to a supplier who prevails in litigation.

Limitations

Section 7 contemplates a four-year statute of limitations, which may be far longer than necessary under the circumstances. It is extremely doubtful that a dealership would be terminated or not renewed without the immediate knowledge of the dealer. Also, the establishment of a new dealership agreement within a dealer's existing territory should come quickly to the attention of a dealer. Exposing a supplier to potential liability for as much as four years after the act which may be the cause of the liability strikes us as unfair to suppliers.

Antitrust laws

A fair reading of *American Motor Inns* v. *Holiday Inns, (supra),* leads us to question how this legislation could require a supplier to consult with his dealers and not simultaneously modify or supersede the antitrust laws of the United States, particularly Section 1 of the Sherman Act.

Effect on contract

Two questions are raised by this section: First, is any resolution of rights and obligations under this bill, short of a finding by a court, proscribed by this section? Would the parties be barred from executing mutual releases? Second, it may be that by rewriting the marketing area's existing dealership agreements and by requiring some form of payment upon termination or nonrenewal that the legislation would be enacting a law abridging the obligations of contract in violation of Article I, Section 10 of the Constitution. While the contracts clause expressly applies only to state legislation, the United States Supreme Court has extended to the federal government the same prohibition in *Lynch* v. *United States,* 292 U.S. 571, 579 (1934). See also *Wippenfurth* v. *The U-Haul Company of Western Wisconsin, Inc.,* CCH Business Franchise Guide, paragraph 7683, Wisconsin Supreme Court, No. 80-144, April 29, 1981.

Conclusion

S. 1256 must be narrowed to apply exclusively to the office machinery industry. It is wholly inappropriate to apply it to all forms of franchises and dealership agreements. Should the committee decide that some form of protection is necessary for office machinery dealers, we suggest a very critical look at the concept proposed in this legislation of establishing dealer cartels. We believe that such a remedy is radical and unnecessary to deal with most of the problems within any industry. Finally, the legislation raises many technical issues which should be resolved by this subcommittee before further action is considered. We thank you for the opportunity to present our views to you and are willing to answer any questions which you may have of us.

QUESTIONS OF SENATOR EXON AND THE ANSWERS THERETO

Question and Answer 1. You asked whether the office machine equipment dealers are confronting a pervasive problem for which no suitable remedy exists. After listening to the testimony of the proponents of the legislation I agree that there is a problem within the industry. Unreasonable quotas, and untested merchandise stand out in my mind as some major problems. As I observed in my oral remarks, there certainly is a problem, one to which we in franchising are especially sensitive. It is a serious dealer relations problem.

As an outsider with no knowledge of the office machinery equipment industry, I would look for the other side of the story as well. I understand no one from the office machinery equipment manufacturers' side was invited to testify. Until hearing their side, I would be uneasy in concluding how widespread the problem is or that no remedies exist. Hearing the testimony, which was extremely well prepared and presented, it is like reading a complaint filed in lawsuit. Unless you've heard the other side, you're likely to conclude that the plaintiff's side should prevail.

After discussing possible remedies with our lawyers, I have been told that several may exist. The Uniform Commercial Code, section 1-203 imposes a duty of good faith and fair dealing in commercial contracts. Applicability of this standard to dealership arrangements has been acknowledged by the Fifth Circuit Court of Appeals in *Corenswet, Inc. Amana Refrigeration, Inc.* 594 F. 2d 129 (5th Cir. 1979) cert. den. (— U.S. —, 1979). That case also stands for the proposition that public policy abhors "economic overreaching . . . the use of superior bargaining power to secure a grossly 'unfair' advantage. . . . It is the office of the unconscionability concept to strike down 'unfair' contract terms." Citing *Shell Oil Company* v. *Marinello,* 68 NJ, 307 A. 2d 598 (1973). Some of the dealers' problems may be subject to

review under the unconscionability standards of the U.C.C. and the *Corenswet* decision as well.

Dealers may also find remedies available under the so called Missouri Doctrine outlined in *DesMoines Blue Ribbon Distributors, Inc.* v. *Drewry's, Inc. U.S.A., Inc.*, 256 Iowa 899, 129 N.W. 2d 731 (1964). That case stands for the proposition that a dealership agreement must continue in force for a reasonable period of time, which is reasonable to recoup the initial investment in the dealership.

One complaint of the proponents was that most manufacturers have refused to sign the model dealership agreement. If their refusal is the result of agreement or other joint or concerted action, that would constitute a violation of Section 1 of the Sherman Act. Also, if terminations are threatened because dealers refuse to sell other product lines of the manufacturer, refuse to sell at recommended prices, or refuse to confine their sales activities to certain prescribed territories, these terminations or threats are subject to antitrust remedies of Section 1 of the Sherman Act, Section 3 of the Clayton Act, Section 5 of the FTC Act and similar provisions in state antitrust laws.

If a dealer is terminated by a manufacturer because the manufacturer has established a company owned branch, the dealer may be able to lodge charges of monopolization under Section 2 of the Sherman Act and similar state anti-trust provisions.

Issues pertaining to warranties and misrepresentation are governed by various state and federal laws. In other words, legal remedies do exist for many of the complaints.

Finally, I would disagree that every claim of bad faith alleged by the proponents in fact an act of bad faith deserving of some type of legal remedy. For example, it is far from settled that the dealer should entitled to "good will" because of the reputation a product has developed. It would also seem contrary to our nation's antitrust policies to preclude a manufacturer from changing its form of distribution or substituting distributors. Understandably occasional hardships may follow from such decisions. But Congress should prohibit or restrict changes in manufacturers marketing programs.

Question and Answer 2. You ask me to respond to an informal unpublished comment of the FTC about the antitrust implications of S. 1256. Obviously I don't have a good response. I can simply point out that under two prior administrations, when legislation pertaining to general franchise termination or non-renewal legislation has been considered by the Congress, the FTC was joined by the Justice Department, Small Business Administration and Commerce Department in opposition to it.[1] Moreover, with respect to Louisiana State Legislation which was proposed to establish exclusive territorial protection for franchisees in the hotel and motel business, FTC staff from both Competition and Consumer Protection Bureaus expressed serious reservations about the anti-competitive aspects of the proposal.[2] Finally, notwithstanding the bill's statement that it does not in any way affect the antitrust laws, the clear intent of the bill is to change the antitrust laws. For example the *American Motor Inn* v. *Holiday Inns* decision cited in my written testimony prohibits a franchisor or manufacturer from consulting with nearby franchisees or dealers before establishing a new franchise or dealership. S. 1256 would expressly contradict that policy and require consultation. Moreover, the fact that the bill acknowledges that more than one dealer in an area could protest the establishment of a new dealership invites existing dealers to confer among themselves and agree to a joint protest. Without specific exemption from the antitrust laws, that conduct is nothing less than a conspiracy which would be subject to severe sanctions under Section 1 of the Sherman Act.

Finally within the marketplace a manufacturer or franchisor may unilaterally decide to deal or refuse to deal with another individual. That was the holding of the Supreme Court in *U.S.* v. *Colgate and Co.*, 250 U.S. 300 (1919) which is still the law of the land today. This legislation would in many cases preclude a manufacturer from making that unilateral decision not to deal.

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[1] See hearings before Subcommittee on Consumer Protection and Finance, Committee on Interstate and Foreign Commerce, House of Representatives, 94th Congress on H.R. 8349, H.R. 8982, March 9, 10 and 11, 1976, Serial No. 94-99.

Hearings before Committee on Commerce, United States Senate, 94th Congress on S. 2335, April 7 and 8, 1976, Serial No. 94-74.

Franchising Termination Practices Reform Act Hearing before Sub-Committee on Consumer Protection and Finance of the Committee on Interstate and Foreign Commerce, House of Representatives, 95th Congress, 1st Session on H.R. 5016 and H.R. 9144, September 16, and 23, 1977, Serial No. 95-84.

[2] A copy of their testimony is attached.

Question and Answer 3. As I noted in pages 9 and 10 of my written testimony it is not clear to me that a dealer has a cause of action only if a new dealership is established without his knowledge. If the dealer has a right to object, it would seem that he would object to a federal district court. The legislation awards courts jurisdiction to exercise their equity powers to grant temporary restraining orders and preliminary injunctions to carry out the functions of the act. Even if a court refuses to grant a temporary restraining order or preliminary injunction, a manufacturer would be at risk of having his new dealership arrangements subsequently overturned by the court. What happens to the new dealer as a result of the subsequent action is not addressed by the legislation. The uncertainty imposed on the manufacturer while the decision making process takes its course is a matter of major concern to any party contemplating a business investment.

Finally the criteria for determining whether a new dealership is warranted is far from clear. The criteria are not limited; a court can look to issues other than those outlined in the bill. There are no guidelines as to which factor should be considered more or less important. I can only imagine that if a dealer challenges the establishment of new dealership, a trial would be required at which time both the manufacturer and the dealer would present marketing expert witnesses who would spend days going through various economic criteria to try to convince the court that the manufacturers decision was right or wrong. In effect, the court would be ruling on the propriety both of the marketing plans of manufacturer and its application in the particular instance.

There is no clear way to be assured that if one court has approved the marketing plan that another court will not find some flaw with it. As a result, any future expansion through dealerships would be undertaken at grave risks of prolonged and expensive litigation.

IFA became involved as a *amicus curiae* in the *GTE Sylvania* case because the *Schwinn* case had held that per se illegality attached whenever a manufacturer attempted to restrict to whom a product could be sold or where a product could be sold, after dominion and control over the product had left the manufacturer. The basis of the *Schwinn* decision, that intrabrand territorial and customer restraints were always lacking in competitive value, was a bankrupt and unjustifiable proposition given the facts of distribution. The *Sylvania* decision has been applauded by manufacturers and dealers alike. The risk manufacturers faced in granting territorial prohibition has been substantially reduced. The cases brought to light by the proponents of the legislation have indicated that primary areas of responsibility or exclusive territories are often granted in the office equipment machinery industry.

This would not have been permissible during the reign of the *Schwinn* decision. However, the *Sylvania* decision does not make every dealer restriction or territorial restriction per se lawful. That seems to be the argument advanced by this legislation's proponents. We agree that territorial decision should be made on a case by case basis, on a manufacturer to dealer basis, rather than under the circumstances described in S. 1256 in which any decision made by manufacturer is made at its peril.

This is a response to the first question submitted by Senator Pressler, Bruce Cotton. The second question was the result of a misunderstanding about pending FTC action, and is not addressed.

Senator Pressler inquires about our statement that the problems alleged in the office machinery industry do not extend to other industries. He indicates that Congress on a number of occasions heard testimony from franchisees complaining about what they consider unfair business practices. The answer is simply that different industries from time to time have experienced different problems. In the petroleum industry Congress reacted to a multiplicity of state laws governing gasoline dealer terminations in an era when major changes affected that industry. The result was that legislation was fashioned to specifically remedy the problems alleged to have existed in that industry. The legislation was a compromise between representatives of dealers and producers and refiners.

In other cases dealers and franchisees have appeared in behalf of legislation designed to regulate terminations and non-renewal of franchise and dealership agreements. IFA has participated in each of those hearings and a result of those hearings we believe relevant Congressional committees have appropriately concluded that no problems of significant multi-industry magnitude have been discovered to warrant legislation. In fact, since these hearings were conducted the Federal Trade Commission franchising trade regulation rule has been issued. The FTC franchising staff has advised franchisors that the number of complaints they have received from franchisees had been reduced by 95 percent. U.S. Department of Commerce statistics also contradict the contention that the termination, and non-renewal issue is a

significant and pervasive multi-industry problem in franchising. A summary of the Department of Commerce figures was submitted to you during the hearing.

Moreover Congressman James Scheuer of New York, then Chairman of the Consumer Protection and Finance Subcommittee of the House Interstate and Foreign Commerce Committee, the committee which has jurisdiction over franchising legislation characterize the *Mikva* termination and non-renewal provision as draconian and said that it should be avoided unless no other alternative exists. In his speech to the International Franchise Association annual convention in 1980 Chairman Scheuer observed that disclosure regulation, such as the one adopted by the Federal Trade Commission should be advanced first to "see how it works before urging adoption of such (termination and nonrenewal) legislation."

The record does contain complaints. But they have not been so many or so serious as to demand legislative action.

Senator PRESSLER. Thank you very much for your interesting testimony. I was fascinated by the percentage of our economy that is affected by franchising activity. It is very high. I think the material you brought sheds light we very much need here.

And next we will have the testimony of Robert R. Lynch, senior vice president, Radio Shack, Division of Tandy Corp., Fort Worth, Tex.

Mr. Lynch?

STATEMENT OF ROBERT R. LYNCH, SENIOR VICE PRESIDENT, RADIO SHACK DEALER DIVISION, TANDY CORP., FORT WORTH, TEX.

Mr. Lynch. Thank you, Mr. Chairman.

My name is Robert Lynch. I am the senior vice president of the Dealer Franchise Division of Radio Shack Division of Tandy Corp. We, too, are members, active members, of the International Franchise Association, where I serve on the board of directors and on the audit committee.

I am here to express my company's strong opposition to S. 1256. Let me give you a brief description of Radio Shack and what it does.

Radio Shack is a worldwide organization with 26,000 employees and 8,300 outlets. We own approximately 5,200 of these outlets, and the other 2,900 are either dealers or franchisees. We are a combination manufacturer, wholesaler, and retailer with 28 factories, 23 of which are located in the United States.

Our concern stems from the fact that we have had great success with the introduction of the microcomputer, to the extent that from its introduction in 1977, we have found it necessary to construct six factories to support peripheral software and hardware.

I, too, am shocked at the testimony of the previous witnesses, since our policy is 100-percent inspection of all new products. It brings a smile to my face when I hear of field testing equipment when I have dealers screaming for equipment and it has not yet passed quality control. We are better than 99-percent efficient out of the box. Our volume is $1.7 billion a year. Composing 21.8 percent of that are computer products and peripherals.

In the United States, we operate 4,200 company stores, 100 franchise stores, and approximately 2,000 dealer stores.

A brief profile of the dealer program. It was organized in 1972 for two reasons—one, we wanted out of the mail order business, and we wanted to cover small markets; two, much of our national

advertising in television and so forth was being wasted since the rain falls on the cities and the towns.

We have a very loose agreement. It is a 1-year, self-renewing agreement with nonescalating quotas. The first contract I signed in January of 1972 has the same quota as the last one I signed. That is $10,000 a year. This is a nominal amount established simply because we felt we could not keep books on an account for less than $10,000 a year. I am happy to state that the average dealer purchase last year was $53,812 and growing.

Our concern is the fact that the computer business is growing so rapidly that we may find ourselves de facto office equipment distributors or manufacturers. To become a dealer with Radio Shack, a retailer must be already established and prove to us his financial viability. We then become the icing on his cake and not the meat and potatoes of his operation.

We print a nonexclusive factor in our contract in bold type. I recall the paragraph. A copy of our contract has been submitted to the committee.

The paragraph, 11(e), states: "The company reserves the unrestricted unilateral right to establish additional dealers and company stores." This has not been a problem with us, nor has it been a problem with our dealers. When we are satsifactorily covering a market, it does not behoove us to go in with additional units if we are getting our sales per capita.

Our specific objections to S. 1256 are as follows:

One, it is overly broad. I have an agreement. We sell 2,600 items. Do I need an additional agreement for office equipment? How much will the 21.8 percent of our computer mix grow in the years? Will it become 90 percent? I don't know.

Two, our agreement is nonexclusive. What would be the status of my agreements, if this legislation were passed?

Three, my dealers would be hurt. You see, approximately 4 percent of our dealerships transfer ownership each year. This would, under this legislation, become a new outlet, a new dealer. Having to wait 60 days to see if you are going to get your money for your business, I feel is manifestly unfair.

Four, we have 100 franchise stores, each of which have been granted an area of primary responsibility which permits them the right to open needed additional units within that area. That is, they have the right of first refusal. If a dealer store were located on the perimeter of an area of primary responsibility, a franchisee might find his hands tied and might find himself involved in costly litigation.

Five, if this law existed in 1972, I can assure you—and I was the author of the dealer contract and the dealer program—the dealer program would never have come into existence.

Six, I, too, as Bruce Cotton has expressed—feel we are flying in the face of the Holiday Inn-AMI litigation in terms of the radius factor.

In closing, I would like to say, I do not feel that we should put the courts in the marketing business. They are overburdened at present, and this would only add to the upset. I feel and my company feels that S. 1256 is unneeded and unworkable.

I thank you very much, Mr. Chairman, for your time, and I am willing to answer any questions you may have.

[The statement follows:]

STATEMENT OF ROBERT R. LYNCH, SENIOR VICE PRESIDENT, RADIO SHACK, DIVISION OF TANDY CORP., FORT WORTH, TEX.

My name is Robert R. Lynch. I am Senior Vice President of the Radio Shack Dealer Division, Tandy Corporation, of Fort Worth, Texas. I appreciate the opportunity to testify before this committee and to express my company's strong opposition to S. 1256.

I want to give you a brief description of Radio Shack. We are a combination manufacturer, wholesaler and retailer of consumer electronic products. We carry approximately 2,600 products, plus computer items. We operate approximately 4,200 company stores, approximately 100 franchise stores, and approximately 2,000 dealer stores in the United States. Our dealers are located in fifty states. It is the dealer program with which we are most concerned, as it relates to this proposed legislation.

The dealer program was established in 1972 as an adjunct to our merchandising plans. Dealers were established in small towns and communities, usually with less than 8,500 population. Licenses were granted to existing retail establishments; that is, these merchants were not dependent upon us for a livelihood. They were already established and our business was strictly an adjunct to their existing retail business. This enables us to cover the market and make maximum use of our advertising. The contract is a very loose one, calling for purchases of merchandise of their choice of $10,000 per year. There is a one-time fee of $3,000 and an initial inventory purhcase requirement of $10,000.

To make certain that we don't have unhappy dealers, we offer to fully refund the fee and to repurchase the inventory during the twelth month of operation if, for any reason, the dealer is unsatisfied.

In August of 1977 we introduced the TRS 80 computer. This computer is designed for home use, businesses and hobbyists. Success of this product has necessitated the construction of six factories here in the United States, employing 1,600 people.

Now, the problem I see with the proposed legislation is that, first, there is an overly broad definition of products. Many, in fact, most of our products can be used in the home as well as in a business or office environment. Therefore, one would be had pressed to determine whether or not an item was designed for a business environment.

We have just one "dealer agreement", and it governs all of the products we sell. It would be impractical to separate an agreement into separate agreements for each of our 2,600 products that we sell through our dealers.

Second, our dealer agreement is nonexclusive. We publish this to our dealers in our contract, a copy of which has been submitted, in capital letters with the company reserving the unconditional right to open additional dealer stores and more company stores. My question is this: What would be the status of my contracts if this bill were passed? A one hundred mile radius, if my calculations are correct, would grant a dealer an exclusive territory of over 31,400 square miles.

Third, our dealers would be hurt by this bill, too. They couldn't sell their dealerships without running the risk of a long court battle. Our 2,000 dealers have built up good businesses and could suffer substantial financial losses as a result of this bill.

Fourth, our 100 franchised Radio Shack stores are assigned a primary area of responsibility. Within that area we grant our franchises the first right to purchase a new franchised store. If our dealers are within one hundred miles of a franchised store, they could deprive our franchisees of the rights they have paid for.

Fifth, if this legislation had been law five years ago, Radio Shack would never have been able to expand and grow to the point it has. We would not have granted dealerships, because we couldn't afford to tie up so many thousands of square miles. We would have been forced, in my opinion, to expand exclusively through company-owned stores.

Sixth, the practice of sending radius letters to nearby dealers has been frowned upon by the federal courts in the past. I've been advised by counsel time and time again that expansion of our dealer program as well as our company store program must be done unilaterally, by the company, and not in consultation with dealers or franchisees. The bill would force us to do what the antitrust laws forbid us to do. Since this bill wouldn't change the antitrust laws, we couldn't grant another dealership or accept a proposed transferee without risking litigation under this bill, the antitrust laws, or both.

Finally, it would be difficult if not impossible for the courts to establish the propriety of the establishment of a new dealership. It is doubtful that the court could determine without long study the propriety of a new location. Courts are already over-crowded and not equipped or designed to make this type of decision. This would, I believe, introduce chaos into our federal court system as well as unwarranted expense.

In summary, I believe the legislation is unneeded and unworkable.

Thank you for your consideration.

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS THERETO

Question. Would you please explain the conflict you see between this legislation and existing anti-trust laws?

Answer. First let me explain that I am not a lawyer and am speaking only as a businessman who has had some practical exposure to our anti-trust laws. It is my understanding that in the absence of a defined territory or AOPR created by contract and offering expansion opportunities or right of first refusal that a manufacturer, distributor or franchisor may not seek agreement or objections from existing dealers. Mr. Bruce Cotton's testimony cited the actual case of *AMI* v. *Holiday Inns*. As I recall the case, Holiday Inns, in an effort to preserve good franchise relations circulated a radius letter soliciting the opinions of other franchise holders within a 25 mile radius. As I further recall, AMI applied for a franchise in New Jersey. A franchisee within the 25 mile radius objected and AMI was denied the franchise. AMI brought suit in Federal court and prevailed. The court found such communication to be an attempt to restrain competition. I have been instructed time and time again by counsel that the decision to open new units must rest solely with the company and that to discuss the prospect of new units with existing dealers might place us in violation of the anti-trust laws.

Question. If you feel that this legislation is not the answer in curbing abusive practices by manufacturers, do you have any suggestions as to what could be done to encourage good faith dealings between manufacturers and their dealers?

Answer. I have no specific suggestions as to how office machinery dealers might improve their bargaining position with foreign manufacturers. If memory serves me, there are over 900 office machinery suppliers and 27 of these suppliers have signed what was referred to as the "Model Dealer Agreement". It appears to me that the dealer association has taken an intelligent approach to the solution of their problems. Obviously the 27 suppliers who were willing to commit to writing the intent to deal in good faith will no doubt receive favorable consideration from the dealers. From then on, Senator, it is a question of time and competition. If these 27 firms succeed, other manufacturers and suppliers will be forced by competitive pressure to match the service and the ethics supplied by the minority group.

QUESTIONS OF SENATOR EXON AND THE ANSWERS THERETO

Question. If the definition of products could be further refined, would this remove your main objection to the bill?

Answer. While a further refinement in the definition of products would provide a temporary sense of security, it would not remove our main objection to the bill. Once the precedent is set that a particular group of merchants can receive protection from competition through legislation, what is to prevent other classes of dealers from seeking the sme legislative relief? Even if the definition were refined, the bill would still restrain competition and I believe the growth of distributional systems dependent upon dealers.

Question. All S. 1256 requires is notification to existing dealers of establishment of new dealerships in the area defined in their agreement as their market area. How would simple notification violate the antitrust laws?

Answer. If a dealership has been granted a specific market area with specific marketing obligations, simple notification might not violate the antitrust laws if such notification was called for in the original contract. The fact remains as pointed out in my answer to Senator Pressler's first question (attached), that such contracts must be constructed to avoid the existence of conspiracy, however benign its intent.

Question. Courts are often required to rule on business matters. How difficult and complex are the issues involved in deciding the propriety of a new dealership?

Answer. There are many criteria for expansion as there are industries and distributional schemes. I know that years ago in the appliance and electronic industries share of market was used as the criterion. Other industries use sales per capita as compared to a national average. Newer firms are simply using "how to beat last year?" Under your proposed legislation, it appears to me that the court would have

to become an expert at whatever industry or method that was involved in litigation, and fashion company or industry expansion criteria.

Senator PRESSLER. I want to thank all four of you for your fine testimony. We now have one of those situations that Senators find themselves in. We have a vote on the Senate floor. I'm going to wait until the second bells ring, which will mean that I have 7½ minutes to get there, and then I'm going to leave the remainder of the questions to be asked for the record.

I have three questions for Mr. Steele from Senator Exon. These will be submitted for the record.

I also have a question I wold like you to answer here. Does the Super 8 organization have any system for resolving disputes between franchisees and the parent company? And if there is no formal procedure, would this bill encourage you to create such a dispute resolution system?

Mr. STEELE. Senator, we are a young, small company. Our oldest franchise is only 7 years old, operating on a 20-year agreement. We have not had severe dispute problems with our franchisees up to this time.

We do have one problem that is in the courts right now, and there is a remedy procedure for that. But most of ours are handled on a gentlemanly basis where we sit down and talk it over and come to a mutual agreement that both parties can live with.

Senator PRESSLER. You are a good example of what small business can accomplish. I am very proud of you, Super 8, having started in Aberdeen, S. Dak.

Mr. STEELE. Thank you.

Senator PRESSLER. I hope to see you later today or later this morning.

I have to run to something in about 1 minute.

Mr. Lynch, I have three questions for you. I will ask the third one here. The other two are for the record.

You mentioned the success you have had with the TRS-80 computer. I am glad to hear of this success.

However, let's suppose there had been some technical flaw with the machine. What action would Tandy Corp. take in response to the ensuing complaints from dealers?

Mr. LYNCH. We provide for our dealers a warranty accrual, a percentage of their sales from us each year. We guarantee to our dealers the same guarantee as is made to a retail customer. If it is 90 days, then of course we will stand in back of it. The dealer has the option of returning that product to one of our—I believe 180 service centers located throughout the United States for free repair, or he has the option of repairing it himself. We furnish the parts free of charge. Then his warranty accrual would not be charged with the labor involved.

Consequently each July at the close of our fiscal year, many of our dealers receive substantial credits or checks for the work that they have done in repairing merchandise without our help.

Does that answer your question, Senator?

Senator PRESSLER. That is very helpful. And I would go on further with you except that I am down to about 5 minutes.

Mr. Cotton, I will just read this question. Staff will provide you with it, and I have to close the hearing.

You mentioned that the obvious problems which are alleged to exist in the office machine industry do not extend to other industries. What basis do you have for making such a broad statement, especially in light of the fact that the Congress has on a number of occasions heard testimony from franchisees complaining about what they consider to be unfair business practices?

I apologize for having to run to the floor, but I have to spend about a half-hour over there, and I cannot ask you to wait that long.

I want to thank the various witnesses who have traveled so far. I think we have shed a lot of light. I will give the questions to staff, and also if Senator Exon's staff has some questions for any of the witnesses, we can give them in writing to the witnesses and get their written responses for the record.

I will run straight to the floor. I do not even have a chance to say goodby, but thank you very much.

[Whereupon, at 12 o'clock noon, the hearing was adjourned.]

[The following information was subsequently received for the record:]

STATEMENT OF A. G. W. BIDDLE, PRESIDENT, COMPUTER AND COMMUNICATIONS INDUSTRY ASSOCIATION

I am A. G. W. Biddle, President of the Computer & Communications Industry Association (CCIA). The CCIA represents some 70 leading manufacturers and providers of computers, magnetic storage systems, printers, terminals, data communications equipment and services as well as data processing services. Our member firms range in size from under one million dollars in annual revenues to well over $500 million. Together they generate annual revenues in excess of $4 billion and generate over 100 thousand jobs.

On behalf of our member companies, we appreciate this opportunity to make a statement before the Subcommittee on Business, Trade and Tourism of the Senate Commerce Committee on S. 1256, The Retail Dealers' Agreement Act. We are very concerned about the impact that this pending legislation would have on CCIA's members, but we trust that the members of this Subcommittee, being dedicated to the preservation of the American free enterprise system will not take initiatives which would adversely affect the many firms comprising the small and medium-sized business sector of our economy.

It is our judgment that The Retail Dealers' Agreement Act is unnecessary and imprudent legislation. There has been no substantial showing that the public interest would be served by legislation of this kind, and many of CCIA's member companies have expressed alarm over the uncertainties and interference with established manufacturer-dealer business relationships which this Bill would create.

These relationships, governed by contract, have sufficient stature to be constitutionally protected.

Article I, Section 10, of the United States Constitution states that no State shall pass any law impairing the obligation of contracts. While this would be an Act of the United States, the legislation goes against the spirit of the Constitution protecting the sanctity of contracts. There has been no showing that the contract process upon which United States commercial enterprise is based need be replaced by the pervasive government regulation which this legislation would impose.

Let me give you an example of how S. 1256 would adversely impact just one of CCIA's member companies. The company manufactures business computers and markets both the hardware and compatible vertical applications software acquired or developed by the company through independent distributors and sales representatives within the continental United States. The company sells equipment to distributors who then remarket the equipment directly to their own customers. Sales representatives arrange for the sale of equipment directly from the company to its customers. Applications software is licensed directly to end-users by the company.

Each distributor and sales representative (hereafter, "distributor") has a defined sales territory, which encompasses portions of or an entire state, although focused primarily around a major U.S. population center, and which does not overlap with

the territory of other distributors. Each distributor has an established sales quota which takes into account the length of time the entity has been in business, prior sales performance, and the particular location of the distributor or sales representative, all based on an established consistent nationwide formula. A distributor is free within its territory to contract with subdistributors within the assigned territory to sell the company's products on the distributors behalf, either on an exclusive territorial arrangement or within an undefined territory.

The company also has agreements with a number of independent software vendors, guaranteeing them national advertising coverage at the manufacturer's expense in exchange for the vendors agreement to sell its own vertical market applications software products in connection with sales of the manufacturer's equipment within the defined distributor territories.

In addition, the company has under consideration a program to enhance its existing distribution network with a non-exclusive subdealer arrangement. Such a program, which would provide more intensive market coverage, would also be placed in limbo under the terms of this Bill.

The company primarily objects to Sections (3)(a)(4) and (3)(b) of the Act. In particular, Section (3)(a)(4) of S. 1256 presents several potentially substantial problems for their existing distribution arrangement. First, a distributor would be faced with a situation where it is possibly limited to using only a single subdistributor, whose self-interest in retaining an exclusive territory would conflict with the value to a distributor of thoroughly penetrating a market with additional subdistributors, and the benefit of the ebb and flow of free enterprise in weeding out unsuccessful performers.

Second, the company's current distributorship agreement permits it to reduce the territory of, or cancel, a distributor who fails to meet quotas. In such events, the company might want to expand another distributor's territory into the reduced territory, or to appoint a new distributor for that territory. Although by its terms the Retail Dealers' Agreement Act does not deal with these situations, the company is concerned that the provisions of Section (3)(b)(2) might, by extrapolation, be held by a court to limit their business judgment in such instances. The courts are neither equipped to, nor the appropriate decision makers to, resolve business questions of the type which Section (3)(b)(2) encourages. The administrative inclusion of the federal courts to establish the propriety of the establishment of a new dealership would lead to an unwarranted burden on the courts and prove to be wasteful and inconclusive to all concerned. That section is a total disincentive to competition and to the free market play which is absolutely essential to rapid and creative growth within the electronics industry.

Third, the definitions of "dealer" and "product" in the Act are so broad that one of the company's independent software vendors, when licensing its vertical market software within a territory, could object to the company's appointment of a distributor to sell equipment and license other of the company's non-competing software products within that territory, giving rise to the inquiry under Secton (3)(b)(2). Although the two "dealers" would be selling different products and would not be in direct competition with one another, the Act as drafted permits this absurd circumstance.

Other terms in S. 1256 are equally troubling. The basic "good faith" standard upon which the bill is based is seriously flawed. The Act depends heavily on this term and, in so doing, fails as an absurd attempt to legislate the connundrums of human behaviors and relationships. In addition, the Act would be constitutionally void for vagueness. "Good faith," as defined in this legislation, by the terms "fair," "equitable," and "ethical" is not a legally sufficient standard. Thus, the bill has as its foundation no discernable objective standard to prevent its arbitrary and abusive application. Since it will itself invite arbitrary application, it is itself an unfair, unequitable, and unethical expression of government intrusion in business relationships. Further, the substance of Section (3)(a)(1) already exists for a dealer's protection, by virtue of the ability of any party to avoid a contract entered into on the basis of fraud.

The effective a of the aforementioned subdealer business plan could also be totally eliminated by Section 3(b)(2). Within a given population center only one "non-exclusive" subdealer might be able to represent the company's products, voiding the entire purpose of the plan. Transfer of such a subdealership would also be handicapped by the potential ability of another dealer to object, and would minimize if not negate entirely the attractiveness to a potential buyer of such a subdealership. Finally, the value of competition in producing effective market penetration would be eliminated.

Furthermore, we question whether this Act is not in fact inconsistent with federal regulations and antitrust laws to the extent that territorial restraints arguably are

not longer imposed unilaterally by the supplier, or are imposed uniformly under the Act for any size business regardless of market share or the reasonableness of such restraint. In addition, requirements forcing consultation between manufacturers and dealers or franchisees are inconsistent with the antitrust laws. For example, such a consultation may possibly be an unlawful combination under those laws.

CCIA's member companies are opposed to the Bill as it would require separate agreements for each separate product sold by a company's dealer representative. This requirement is not only unmanageable, it is inconsistent with the needs of business, and will simply add to the costs and complexity of doing business. The provision in Section 3 which provides for additional unearned compensation at the end of a dealer agreement is simply a windfall to dealers, adding to the costs of doing business and increasing product prices.

The provisions in the Act which would grant exclusive territories to each dealer of over 31,400 miles is also inconsistent with this nation's abhorrence of monopolies. Entrenched dealers will not have any incentive to keep prices low and services at a high level.

Dealers who prefer an exclusive sales environment have as an option manufacturers/distributors who provide that kind of protection. Those who choose the non-exclusive environment should be willing to live within the context for which they bargained, enjoying the benefits of the unrestrained market in which they do business.

Rights such as the first right to purchase new stores precludes, by definition, the rights of others. In essence, first-come always will be first-served, to the exclusion of new entrants. Rights of others would be disenfranchised and healthy potential competition would be impaired.

The remedies provided by the Bill for damages include an unjustified penalty amounting to a trebling of damages where the violation has found to have been "willful". Even apart from the lack of a proper standard for assessing what "willful" means, such penalties would be excessive and lead inevitably to increased and undesirable litigation.

The net effect of S. 1256 is to guarantee that no supplier can make changes which affect a dealer or his territory without being tied up in court.

Speaking for myself, and for CCIA's 70 member companies, The Retail Dealers Agreement Act is unnecessary and unworkable. We urge the Subcommittee to reject this legislation.

SHARP ELECTRONICS CORP.,
Paramus, N.J., December 2, 1981.

Hon. LARRY PRESSLER,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PRESSLER: We are taking the liberty of sending to you herewith a copy of the letter we have addressed to the National Office Machine Dealers Association and to two of the witnesses who appeared before the Subcommittee on Business, Trade and Tourism to testify on S. 1256, the Retailer Dealers Agreement Act. Our letter is intended to set the record straight with respect to certain false allegations directed specifically at this company and its way of doing business. We would be grateful if the attached letter could be included in the official records of the Subcommittee and in any printed record of the hearing.

Sincerely yours,

S. MORIMOTO,
Executive Vice President,
Industrial Equipment Division.

Enclosure.

SHARP ELECTRONICS CORP.,
Paramus, N.J., December 2, 1981.

Mr. JOE STEWART,
President, National Office Machine Dealers Association, Elk Grove Village, Ill.

DEAR MR. STEWART: On October 29, 1981, officers and members of the National Office Machine Dealers Association testified before the Committee on Commerce, Science and Transportation, Subcommittee on Business, Trade and Tourism of the U.S. Senate in support of the Retail Dealers Agreement Act, S. 1256. As you are aware, Sharp is opposed to that bill for reasons which it set forth in a letter to the Chairman of the Committee on Small Business, Subcommittee on Special Small

Business Problems, U.S. House of Representatives which held hearings on a similar NOMDA-backed bill last year (copy attached).

No one questions the right of NOMDA and its members to seek whatever legislation they think is in their interests or their right to express their views to the Congress. But some of the statements made by witnesses Richard P. Nelson and Merlin Jeitz in regard to this company and the way it does business were so grossly erroneous and misleading that we think it essential that they be corrected in the interests of mutual good faith and fair play.

Mr. Nelson criticized Sharp for setting unreasonably high quotas so as to "keep dealers in line," "provide an excuse for termination," etc. This is untrue and unfair. The quotas Sharp assigns to its dealers are based on a statistical formula for estimating potential sales in the dealer's geographic area which we developed with the advice and approval of the Sharp Dealer Advisory Council of which Mr. Nelson is a member. The quotas which we establish are within production capability and they are used only for the measurement of sales performance for the mutual benefit of Sharp and its dealers.

To illustrate his point, Mr. Nelson used quota figures which were set on a provisional basis for a new product line at the time it was introduced. When actual sales proved lower than anticipated, the quotas were cut by approximately 40 percent. Not one dealer was terminated or threatened with termination for failure to meet the original quotas.

The complaints by Messrs. Nelson and Jeitz about establishment of new dealers "next door" or in their "backyard" are without any basis in fact. The authorized Sharp dealer established nearest Mr. Nelson's Cleveland dealership is located in Akron, Ohio and that nearest Mr. Jeitz's Watertown, South Dakota dealership is in Mitchell, South Dakota, some 125 miles away. Sharp does not believe that its interests are served by intrabrand competition in the distribution of its products, but it is not in a position to prevent dealers from establishing branch offices or otherwise making their own decisions as to where, to whom or at what price to resell Sharp products.

Sharp's policy is to require dealers to service or provide service for the products they sell. Contrary to Mr. Nelson's statement, Sharp has never ordered a dealer to service equipment not sold by him.

There are numerous other points in the testimony offered by NOMDA witnesses with which we take issue, but we are particularly concerned about the false accusations directed specifically at Sharp by name.

We are certain that the overwhelming majority of the NOMDA members with which we deal recognize the groundlessness of the accusations made against us. We hope that Messrs. Nelson and Jeitz will recheck their information and correct their statements, or if they do not do so, that NOMDA will disassociate itself from their erroneous and misleading testimony.

Very truly yours,

J. R. CASTRIANNI,
Vice President, Copier Products Division.

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